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memow/att.	From Brzezinski to The President (2 pp.) re:Emergency Procedures/enclosed in Hutcheson to Carter 3/29/79 1 p. declassified per RAC NLC-126-16-42-1-7 8/22/13	3/29/79	A

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THE PRESIDENT'S SCHEDULE

Thursday - March 29, 1979

7:30	Dr. Zbigniew Brzezinski - Oval Office.
8:00 (60 min.)	Breakfast with Economic Advisors. (Dr. Alfred Kahn) - The Cabinet Room.
9:30	Mr. Frank Moore - The Oval Office.
10:00 (10 min.)	Drop-By Meeting of the Business Advisory Council. (Dr. Alfred Kahn) - Roosevelt Room.
10:30	Meeting with Congressional Leadership/ Energy. (Mr. Frank Moore) - Cabinet Room.
11:30	Mr. Jody Powell - The Oval Office.

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		JORDAN
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		MCINTYRE
		SCHULTZE

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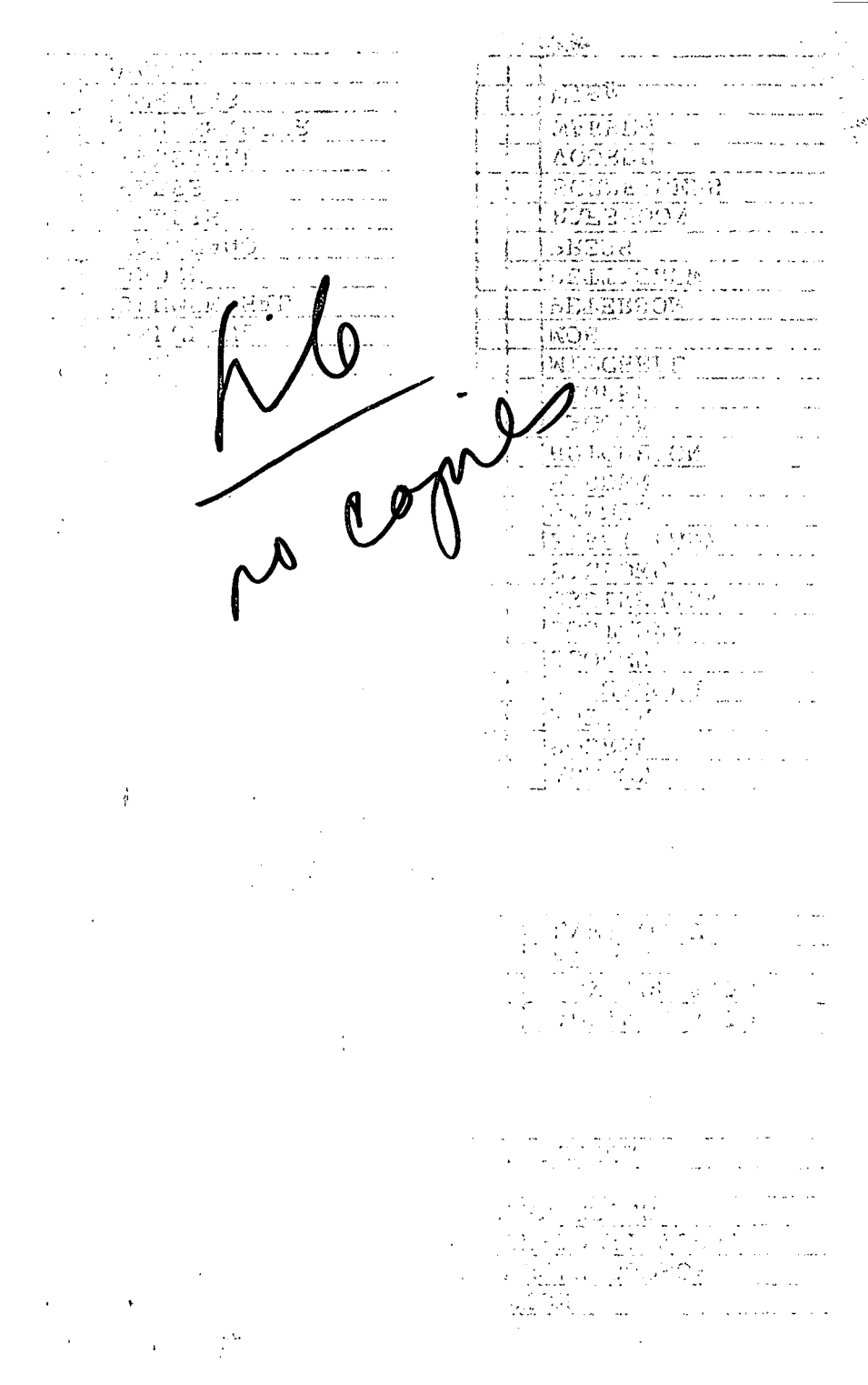
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THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE
WASHINGTON, D.C. 20201

March 28, 1979

C

PERSONAL AND ~~CONFIDENTIAL~~

MEMORANDUM FOR THE PRESIDENT

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FROM: JOE CALIFANO

Since you made your decision to propose the Department of Education, I have supported it actively. And I am, of course, prepared to do whatever else you wish.

I do think it important that you have some sense of what has been done.

- o I have personally written to the Congress on three separate occasions supporting a separate Department.
  - -- At Tab 1 is a copy of a letter I sent to Senator Ribicoff on February 7, 1979, supporting the Department; a similiar letter was sent on May 17, 1978 (and read to the Committee on that day by Hale Champion).
  - -- I wrote to Jack Brooks earlier this week, in response to his request for our achievements over the past two years, not only setting forth your extra-ordinary record in education, but also volunteering my support for the Department of Education (even though he did not ask my view). (Tab 2.)
- o Every high level official from the world of education at HEW has testified in support of your proposal. I think the most persuasive testimony last year for a broad-based Department of Education was given by Hale Champion before the Senate. At my direction, and after personal and delicate conversations with me,

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DETERMINED TO BE AN ADMINISTRATIVE MARKING BY ____ DATE 5/1/90

Hale, Commissioner of Education Boyer and Director of the National Institute of Education Pat Graham--each of whom personally opposes the concept of a separate Department of Education--have gone to the Hill to testify in support of your proposal. Mary Berry, Assistant Secretary for Education, has also testified.

- When friends like Jesse Jackson and Vernon Jordan have "privately and off-the-record" asked me whether they should testify in favor of a separate Department, I have urged them to do so.

I have not personally testified because it was my judgment--shared I assumed (because I talked with them) by Stu Eizenstat and others on your staff--that a personal appearance would be counter-productive.

Prior to the time I became HEW Secretary, I repeatedly wrote and spoke against the concept of constituency-oriented departments, specifically including a separate Department of Education. A portion of my book on the Presidency made this point. So did my testimony some years ago before the same House Committee considering the current bill. My testimony then supported earlier reorganization proposals that would have further consolidated education, welfare, health, and job training in a Human Resources Department, rather than created a separate Education Department.

Since there is so much on the record by me, I felt the Administration only stood to be embarrassed--and the cause of a separate education department hurt--if I testified, thus giving opponents an opportunity to force me to comment on views repeatedly expressed prior to becoming Secretary.

I do disagree with one of the arguments for a separate Department recently advanced by Messrs. McIntyre and Carp--because it belittles the attention that has been paid to education by me and my colleagues and the achievements in education over the past two years. (See, at Tab 3, for example, the Saturday Washington Post article reporting on their press conference.)

Since 1977, by far the lion's share of HEW discretionary fund increases, requested by me and enthusiastically approved by you, has gone to education. During your Presidency, the HEW education budget has increased by $4.8 billion, some 63 percent. And HEW's finest legislative hours have been in this area: the new Elementary and Secondary Education Act legislation, the Middle Income Student Assistance Act, the new legislative focus on basic skills and on flexibility in using desegregation funds. Administratively, we have completely reorganized the Office of Education, and moved to clean up the student assistance programs. As the list of achievements in my letter to Jack Brooks indicates, the Carter Administration has a spectacular record in education.

There are arguments for a separate Department of Education. But I do not believe that a lack of accomplishment in education over the past two years--or lack of attention to it--can fairly be said to be one of those arguments.

TAB 1

THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE
WASHINGTON, D.C. 20201

FEB 7 1979

The Honorable Abraham Ribicoff, Chairman
Senate Government Operations Committee
Washington, D.C. 20510

Dear Mr. Chairman:

I am pleased to record my support for President Carter's recommendation for a Cabinet-level Department of Education.

Since the days in the early 1960's when you were Secretary of HEW, the interest, role and responsibility of the federal government in the sphere of education has dramatically widened and deepened. Since 1961, a steady, solid majority of the Congress has shared the conviction of three Democratic Presidents that the nation's economic progress and social well-being required a new order of federal support for education, and a steadfast national commitment to equal educational opportunity.

With farsighted leadership coming alternately from both the Executive and the Congress, the federal government has, since 1961, put major new foundations of financial assistance in place to supplement without supplanting the historic educational contributions of state and local governments and of independent, public and private institutions.

In elementary and secondary education and in higher education, bold federal legislation has dramatically lowered traditional economic, social, and racial barriers to educational opportunity by channeling federal assistance to individuals and communities with the greatest need.

President Carter's recommendation for a Department of Education complements far-reaching proposals which he has made and which the Congress has approved:

- Expanded federal assistance to students in urban and rural school districts with the greatest need;

- o Expanded Federal responsibility for the costs of education for handicapped children and others with special needs;
- o Increased basic skills training to enhance educational quality;
- o Extended Federal financial aid programs to college students from middle income families.

The President's proposal to give Cabinet-level status to education recognizes our stake in good teaching, and seeks fresh impetus for our shared hope that every child will realize his or her native abilities to the fullest measure. The President's recommendation seeks also to improve the ability of citizens to understand, and local schools and communities to work with the Federal Government in a more fruitful and less burdensome partnership for education.

President Carter's proposal for a Cabinet-level Department of Education flows from well-established national education commitments and aspirations. By actions in his own time, however, the President has unmistakably signalled his conviction that education merits greater national concern and attention.

I share that conviction, and support the President in his belief that a Department of Education can help the nation meet its educational challenges. I hope, Mr. Chairman, that your colleagues in the Senate will join with you and the President to create a Department of Education this year.

Sincerely,

Joseph A. Califano, Jr.

TAB 2

JACK BROOKS, TEX., CHAIRMAN
L. H. FOUNTAIN, N.C.
DANTE B. FASCELL, FLA.
WILLIAM L. HUNGATE, MO.
BENJAMIN S. ROSENTHAL, N.Y.
FERNAND J. ST GERMAIN, R.I.
[illegible] FLA.
JOHN CONYERS, JR., MICH.
CARDISS COLLINS, ILL.
JOHN L. BURTON, CALIF.
RICHARDSON PREYER, N.C.
ROBERT F. DRINAN, MASS.
GLENN ENGLISH, OKLA.
ELLIOTT H. LEVITAS, GA.
DAVID W. EVANS, IND.
ANTHONY MOFFETT, CONN.
ANDREW MAGUIRE, N.J.
LES ASPIN, WIS.
HENRY A. WAXMAN, CALIF.
FLOYD J. FITHIAN, IND.
PETER H. KOSTMAYER, PA.
TED WEISS, N.Y.
MICHAEL L. SYNAR, OKLA.
ROBERT T. MATSUI, CALIF.
EUGENE V. ATKINSON, PA.

NINETY-SIXTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON GOVERNMENT OPERATIONS

2157 Rayburn House Office Building

Washington, D.C. 20515

JOHN N. ERLENBORN, ILL.
JOHN W. WYDLER, N.Y.
CLARENCE J. BROWN, OHIO
PAUL N. MC CLOSKEY, JR.
THOMAS N. KINDNESS, OHIO
ROBERT S. WALKER, PA.
ARLAN STANGELAND, MINN.
M. CALDWELL BUTLER, VA.
LYLE WILLIAMS, OHIO
JIM JEFFRIES, KANS.
OLYMPIA J. SNOWE, MAINE
WAYNE GRISHAM, CALIF.
JOEL DECKARD, IND.

MAJORITY—225-5051
MINORITY—225-5074

March 26, 1979

HEW-OS
MAR 26 4 45 PM '79

The Honorable Joseph A. Califano, Jr.
Secretary of Health, Education, and
Welfare
Washington, D. C. 20201

Dear Mr. Secretary:

As you know, the Subcommittee on Legislation and National Security today began hearings on H. R. 2444, a bill to create a cabinet-level Department of Education. It would be helpful to the subcommittee if you would provide us with a list of achievements your Department has accomplished in the field of education since you became Secretary in early 1977.

With best wishes, I am

Sincerely,

Jack Brooks
Chairman

26 MAR 79 000075

"Dear Jack"

PRIORITY

THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE
WASHINGTON, D.C. 20201

MAR 27 1979

The Honorable Jack Brooks
Chairman
Committee on Government Operations
House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

Thank you for your letter of March 26 asking that I provide you with a list of this Department's achievements in the area of education since I became Secretary in January of 1977.

Under President Carter's leadership, we have made substantial strides in the area of education, and I am pleased to provide you with the following list of achievements in education over the past two years:

FINANCIAL SUPPORT

- Federal support for education programs has increased by more than $4.8 billion--a 63 percent increase during the two years we have been in office.

  -- The increase for Title I of the Elementary and Secondary Education Act of 1965 alone was the largest in the history of that program. Funding for that program has increased from $2.285 billion in FY 1977 to the Administration's request of $3.478 billion in FY 1980.

  -- The Education for the Handicapped States Grant Program has been increased from $252 million in FY 1977 to $862 million requested by the Administration for FY 1980.

  -- Funds for Student Assistance have increased from $3.063 billion in FY 1977 to $4.607 billion requested by the Administration for FY 1980.

-- One of the first budget decisions I made when I took office was to propose funding for the Title III, Developing Institutions program at its full authorization ($120 million).

Not since Lyndon Johnson's Administration has this nation seen such a large increase in the Federal investment in the education of its young people.

LEGISLATIVE

- The Education Amendments of 1978: This legislation embodied nearly all of the Administration's proposals for improvements in the Elementary and Secondary Education Act of 1965, including:

  -- Title I Concentration: a provision authorizing $400 million in new grants to school districts with exceptionally high concentrations of children from low-income families.

  -- Program Improvements: Other Title I provisions included using multi-year application cycles to reduce paperwork and planning burdens, developing school-wide project authority, increasing parental and teacher involvement, and streamlining procedures to improve services in private schools.

  -- Basic Skills: Title II of ESEA provides for a new program to improve the achievement of children in basic skills. Also included was new Federal assistance to States for the development of improved tests to measure students' basic academic skills. This Wednesday I am testifying before the Senate Labor and Human Resources Subcommittee on Education on this important initiative.

- Tuition Tax Credits: The Administration opposed legislation that proposed authorizing tuition tax credits at the elementary, secondary, and postsecondary education levels. In our judgment, enactment of tuition tax credits at the elementary and secondary levels would represent a significant threat to the future of public education in this country. At the postsecondary level, while opposing tax credits, we worked with the Congress to pass the Middle Income Student Assistance Act.

- Passage of the Middle-Income Student Assistance Act: MISAA, while retaining the income-related nature of grant awards, expanded eligibility for student financial aid to approximately one-third of the students enrolled in post-secondary education in order to help students from middle income families defray the rising costs of postsecondary education. For example, in addition to making students from families with incomes of up to $25,000 eligible for BEOG awards, all students, regardless of family income level, became eligible for federally subsidized guaranteed loans.

- Higher Education Act: We are currently developing legislation to reauthorize the Higher Education Act of 1965. I testified just last week before the House Education and Labor Subcommittee on Post Secondary Education on the student financial assistance programs, and we are currently working on proposals relating to other titles of the Act.

- Other Education Legislation: Also scheduled for reauthorization during the 96th Congress is legislation extending the National Institute of Education (NIE) and the Fund for the Improvement of Postsecondary Education (FIPSE). NIE is the principal research agency for education in HEW. FIPSE permits institutions of higher education, administrators and teachers to conduct innovative research on the problems of administration and education at the postsecondary level.

REDUCTION OF FRAUD, ABUSE, AND WASTE

- We launched a major initiative to curb fraud, abuse, and waste in the student assistance programs, and have made substantial progress in clearing up the backlog of defaulted student loans in the Guaranteed Student Loan (GSL) program:

  -- Federal collectors are now converting defaulted GSL accounts to repayment at a rate of 2,500 per week--more than eight times the rate when we took office. In April 1978, there were about 400,000 students in default. By this past March 1st, this number had dropped to about 300,000.

  -- By the end of the first quarter of this year, we will have collected $10 million on defaulted GSL accounts --five times the amount collected during the same quarter in 1977.

-- We instituted Project Cross-Check which seeks to clean up the Federal Government's own house by using computers to match Government payrolls against the Federally Insured Student Loan default file.

-- In the last nine months, we have referred over 4,600 civil cases to U.S. Attorneys, compared to a total of about 500 for the previous 5 years.

-- The result of these efforts is that we have reduced the default rate in GSL from approximately 14 percent in Fiscal Year 1978 to about 10 percent at the present time.

- In the campus-based NDSL program, I recently announced a series of steps HEW will take in cooperation with colleges and universities to reduce a default rate which is now more than 17 percent. These steps include issuing regulations that will set performance standards for reducing institutional default rates, taking over collection of older defaulted loans from institutions, and expanding technical assistance and training for institutions that need help in improving the management of their loan programs.

- We have tightened the administration of the Basic Grant Program. Through computerized edits and verification of data items submitted on student grant applications, we expect to save approximately $500 million.

- We established institutional accountability procedures.

  -- Schools can now be limited, suspended, or terminated from participating in student financial assistance programs.

  -- This year we will conduct about 1,000 program reviews at institutions, compared with 481 last year.

- We have saved more than $13 million this fiscal year in questionable expenditures in the Title I program through increased site visits and program reviews.

REDUCTION OF PAPERWORK BURDEN

- We have eliminated 7.8 million hours of paperwork burden associated with data instruments and forms used by institutions of higher education and State departments of education:

-- We eliminated the requirement for students to fill out separate Federal forms for BEOG grants.

-- We consolidated student applications for federally insured loans.

-- We reduced the frequency of reports required of State educational agencies to one interim and one final report every 12 months instead of once each month or quarterly.

-- We changed submissions of plans from local educational agencies to State educational agencies from annual to every three years with annual updates if necessary.

- We have rewritten regulations in clear English and reduced the time required to issue final regulations.

  -- For education regulations initiated prior to our taking office, it took an average of 659 days to move them through the Federal process. Since we took office in January 1977, we have reduced that time by more than one-third, and we are continuing to cut the time it takes to issue final regulations.

  -- Since September 1977 we have removed 498 pages of obsolete education regulations from the Code of Federal Regulations.

  -- We will soon consolidate in a single regulation more than 1,000 separate program regulation provisions.

REORGANIZATION

- We reorganized the Office of Education in April 1977: by reducing from 28 to 7 the staff units reporting directly to the Commissioner, we have been able to sweep away the clutter that confused policy direction and management in OE for so long.

- We created two Executive Deputy Commissioners in OE: one for educational programs, the other for management, budget, and administration.

- We reorganized the Bureau of Student Financial Assistance by consolidating the six student financial assistance programs administered by OE into a single bureau, and totally rearranged the relationship between headquarters and the regions.

-- previously the administration of the student financial assistance programs was fragmented among three different offices in two bureaus within OE.

- We established a New Bureau of School Improvement to coordinate 20 discretionary grant programs that have been scattered throughout the Office of Education. Placing them in a single office will increase their visibility and prestige and force the programs to consider more effective strategies to increase the national impact of limited funds.

In sum, I believe that our record of accomplishments during the past two years has already firmly established President Carter as one of the greatest education Presidents in the history of our nation.

President Carter's proposal to give Cabinet-level status to education builds on these accomplishments. It recognizes our stake in good teaching, and seeks fresh impetus for our shared hope that every child will realize his or her native abilities to the fullest measure. The President's recommendation seeks also to improve the ability of citizens to understand, and local schools and communities to work with the Federal Government in a more fruitful and less burdensome partnership for education.

The President's proposal for a Cabinet-level Department of Education flows from well-established national education commitments and aspirations. By actions in his own time, the President has unmistakably signalled his conviction that education merits greater national concern and attention.

I share that conviction, and support the President in his belief that a Department of Education can help the nation meet its educational challenges.

I hope this information is helpful to you as you consider the Administration's proposal.

Sincerely,

Joseph A. Califano, Jr.

TAB 3

THE WASHINGTON POST/MARCH 24, 1979

Education Agency Critics Answered Before the Fact

By Spencer Rich
Washington Post Staff Writer

The White House, facing a tough House battle on its proposed Department of Education, yesterday sought to blunt in advance the criticism it expects to surface at House hearings next week.

At a briefing for reporters, Office of Management and Budget Director James. T. McIntyre said creation of the $13.5 billion-a-year, 16,000-employe Cabinet-level department would not mean federal domination of education at the state and local levels, as has been charged by such critics as Rep. John N. Erlenborn R-Il .), one of the chief foes of the proposal.

"The federal role is limited . . . The tradition of state and local control . . . will not be changed," McIntyre said.

Nor would creation of the department necessarily mean ladling out more money for federal education programs, Mcintyre said.

"Just the fact that you create a new department doesn't mean new expenditures," said McIntyre, saying that the proposal eventually would allow 350 to 400 jobs to be eliminated "with a savings of over $100 million [annually] in the long run for greater efficiency."

McIntyre said the biggest gains would came from simplification of decision-ma ing, greater "clout" for education, which would have its own Cabinet-level secretary instead of being run by a relatively low-level assistant secretary in the Department of Health, Education and Welfare, and far more rapid development of regulations.

When a new regulation for an education program is to be promulgated, it normally takes an average of 519 days because it must pass through 26 jurisdictional steps before working its way up to the final approval by the secretary of HEW, McIntyre aides said.

Under the proposed department, the steps would be cut from 26 to 11 and time substantially reduced, he said.

McIntyre said that one of the biggest problems is that HEW Secretary Joseph A. Ca ifano Jr. simply can't pay enough attention to educational matters because 92 percent of his huge $200 billion departmental budget is for welfare and health matters, which "dominate the secretary's attention."

"I don't know anyone who has done a better job than Joe Califano" in running HEW over the years, McIntyre said, but health and welfare so overwhelmingly demand his attention that "educational problems are necessarily pushed aside."

With education in a separate department, "crowding out will be eliminated," he said.

Bert Carp, deputy assistant to the president for domestic affairs and policy, told the briefing that the administration doesn't plan to enlarge the new department beyond its present scope by allowing it, once created, to ulp down some programs that aren't being put into the new department—such as veterans' education, school lunches and labor manpower training.

Carp also said that one of the greatest problems is that, after mak ng decisions, the professional education people in HEW must then fight them up through heavy layers of people in the HEW secretary's office, such as the overall planning, public affairs and legislative staffs, who know far less about education.

The new department is opposed by conservatives like Erlenborn for fear that it would take over all major education decisions from state and local governments, and by the American Federation of Teachers and some other labor and welfare groups for fear it would fragment their existing lobbying coalitions and break desirable links between welfare and education programs for the poor.

However, a big coalition of education organizations, led by the National Education Association, is backing it.

THE WHITE HOUSE
WASHINGTON

29 Mar 79

Hugh Carter

The attached was returned in the President's outbox today and is forwarded to you for appropriate handling.

Rick Hutcheson

Zbig Brzezinski

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		SCHLESINGER
		STRAUSS
		VANCE

MEMORANDUM

THE WHITE HOUSE

WASHINGTON

~~CONFIDENTIAL~~

MEMORANDUM FOR: HUGH CARTER

FROM: ZBIGNIEW BRZEZINSKI

SUBJECT: Emergency Procedures for NSC Affairs (U)

The President has granted me authority to decide when circumstances warrant resort to emergency procedures for my movements and related activities. Circumstances could arise which would make seeking a judgment from you time consuming and in some cases even deny us the benefits of the emergency procedures. (C)

I shall exercise this authority judiciously and only when consulting with you is not practical. (C)

~~CONFIDENTIAL~~
~~Review~~ on February 7, 1985

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		PETTIGREW
	/	PRESS
		RAFSHOON
		SCHNEIDERS
		VOORDE
		WARREN
		WISE

THE WHITE HOUSE
WASHINGTON

29 Mar 79

Stu Eizenstat

The attached was returned in the President's outbox today and is forwarded to you for appropriate handling.

Rick Hutcheson

Frank Press

1215

THE WHITE HOUSE

WASHINGTON

March 24, 1979

Stu - Emphasize in speech J

MEMORANDUM FOR: THE PRESIDENT

FROM: Frank Press F.P.

SUBJECT: The Need to Articulate an Energy Technology Strategy

This is the brief paper you asked me to prepare at the energy meeting on Friday. A more detailed paper, including recommendations for implementing actions, is attached as an Appendix.

Much of the debate on energy focuses understandably on our pressing immediate energy problems. Because of this focus, we have a hard time seeing that the future holds the promise of a world with adequate, and perhaps abundant, energy supply. The general features of a smooth technological evolution to achieve this promise should be strongly enunciated by the Administration, and the Government actions, whether underway or needed to support that strategy should be laid out. By articulating such a strategy, we can reduce some of the anxiety surrounding our debate on energy. This would be an "upbeat" portion of an otherwise "down" speech on energy. Morever, there would be a positive national response to your leadership in marshalling technology to attack our energy problems.

We can be confident that our nation and the world will have begun to reach an era of energy systems using nearly inexhaustible sources sometime in the next century. Indeed, we need not fear the depletion of conventional oil and gas, and the environmental problems associated with fossil fuels generally, as there are answers to these problems beyond the 2020's. To produce electricity, the mainstay of the energy system of the future, we will rely on direct conversion of sunlight to electricity by advanced photovoltaics, on proliferation-resistant breeder reactors, and fusion. We are blessed with very large coal resources and coal will be used as long as it lasts, both directly for heat and power, and indirectly to produce synthetic oil and gas. Unconventional gas, heavy oils, shale oils, and oil sands will all be used in applications where the advantage of fluid fuels are most important, such as in transporation. Efficiency in the transport and use of

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energy--whether in vehicles, consumer durables, or industrial processes--will increase dramatically. In sum, energy supply will likely be diverse and abundant, will be secure from foreign interruption, and increasingly our energy use will be environmentally benign.

How do we get there from here? We must prepare for this not too distant period by laying the basic technological groundwork now. The Federal government, during your Administration, has done a good job in providing both breadth and depth of support, but the level of effort can be increased. Implementing actions are listed on pp. 12-13 of the Appendix.

Smooth evolution into the technologies of the future requires that we prepare for a transition period. In this time period (1990 to 2020), coal will be our most important fuel, both in direct use and as a source of synthetic fuels. Nuclear power grows in importance. Some solar technologies, particularly water heating, space conditioning, agricultural and industrial process heat, biomass, and perhaps photovoltaics, will enter widespread use. Because of the high cost of energy, conservation will have a major impact through this period as new, energy efficient industrial plant and equipment and consumer products are introduced. Indeed, the private sector is already taking energy conserving steps.

To prepare for this transition period, we must work now on new supply and conservation technologies. Given proper price incentives and an improved regulatory environment, the private sector will be able to make the transition to new technologies with relatively smooth and reasonable speed. The Administration must take the lead to remove the serious problems of public acceptance derived from concerns over safety and waste disposal. There are other Government actions that must be undertaken now to facilitate our progress through this period. These are discussed on pp. 7-10 of the Appendix.

For the near term, the next ten years or so, we are focusing on incremental changes to our existing energy system. There can, of course, be no major shifts in the composition of our primary energy supplies in the short period of a decade. But we can and are improving our position, as well as easing our movement through the succeeding periods, by assuring that the private sector is given the leeway and the proper economic signals to adapt efficiently to a changing world. In particular, the price system should reflect

the real cost of new energy systems so as to discourage waste and to initiate the needed technological restructuring. We should also streamline our regulatory and licensing systems to minimize the delay in bringing new coal and nuclear power plants on stream, while maintaining our environmental, health and safety controls. Again, detailed implementating actions are provided on pp. 3-5 and pp. 14-15 of the Appendix.

Our investment in energy technology equals that being spent by the rest of the non-Communist world. However, an energy and transportation fund using a portion of the tax revenues accruing from deregulation can accelerate the research, development and demonstration program. We can invest more in energy R&D without waste, in an enhanced program that would be politically attractive and a symbol to the world that we mean business in attacking our energy problems.

AN ENERGY TECHNOLOGY STRATEGY FOR THE UNITED STATES

Office of Science and Technology Policy

March 1979

Much of the current debate on energy focuses understandably on our pressing immediate problems. Because of this focus, we have a hard time seeing that we can have adequate, and perhaps abundant, energy supplies. By articulating a long-term energy technology strategy, we can reduce some of the anxieties currently behind the debates on energy. Moreover, an improved understanding of the energy system of the future can help us address our current problems more courageously and forthrightly.

Our Nation can devise an explicit long-term energy technology strategy. Although the energy system is too complex to be amenable to simplistic approaches, over time new technologies of many kinds will contribute importantly to easing the nation's energy problems. New technologies can provide new sources of energy and they can permit reductions in the need for energy.

The future technological structure of the nation's energy system cannot be described precisely or in detail, nor can a strategy for altering the structure. The diversity of technological opportunities, the uncertain success of individual R&D efforts, our lack of knowledge of the worldwide resource base, and differing domestic regional resources and needs, all make accurate and specific forecasts of future technological structures impossible. Even aggregate energy consumption cannot be well predicted. However, there is much we can do. The general features of a smooth technological evolution of the energy system can be described, an overall technology strategy can be developed, and the government actions required to support that strategy can be laid out. The evolution described below derives from an evaluation of the expected outcomes of research and development investments, an assumption that policy choices will be made that facilitate the smooth evolution of the energy system, and judgments about the economic conditions that may induce or inhibit technological change and resource utilization. The necessary government actions, and their current status, are also presented.

It is convenient to divide the coming decades into near-term, the mid-term and the far-term.

-- The near-term, roughly the next decade or so, is the period during which only incremental change is possible in the technological structure of the energy system. There can be no major shifts in the composition of the nation's primary energy supplies or the energy efficiency of the stock of plant and equipment.

-- The mid-term, extending from the early 1990's to roughly a quarter of the way into the next century, is the period of transition away from primary dependence on oil and gas toward primary dependence on relatively inexhaustible sources. Some of the new energy supply and conservation techniques deriving from today's investments in research and development by private industry and the government will be in widespread use

during this time frame. Some technologies not yet under development could also be commercialized later in the period.

-- The far-term, beginning roughly a quarter of the way into the next century, is the era of major dependence on inexhaustible energy sources. Many of the most important inexhaustible energy sources require a sustained program of basic and applied research, development and demonstration spanning three or four decades -- a time span that normally occurs in the total process of developing fundamental knowledge and bringing it into societal use.

THE NEAR-TERM

The Next Decade

The Technological Structure

The structure of the energy system in the near-term can be fairly confidently predicted since the technologies which will be in use are almost entirely those which are in use now. Changes from present technology will therefore be incremental modifications to industrial plants, and changes in industrial equipment and consumer durables. Some new technologies, now well into development, may begin to penetrate.

Oil and gas will remain, during this period, the nation's most important primary energy sources. Conventional domestic oil and gas resources will continue to be depleted, including the North Slope. Some new and recently discovered fields will come on line, and enhanced oil recovery and unconventional gas may come into use, but all of these are unlikely to maintain current oil and gas production levels. Imports of oil will therefore remain very high, and the Strategic Petroleum Reserve will be completed to provide an increasingly necessary insurance policy. Our relative dependence on various foreign suppliers of oil may shift. In particular, greatly increased production of oil and gas in Mexico, and possibly Canada and a number of undeveloped nations, may result in increased imports from these relatively secure suppliers.

Coal utilization and nuclear power production will rise substantially, providing virtually all new increments to baseload electric generating capacity. Coal will be utilized in some generating facilities now burning oil or gas, and, to a less predictable extent, in industrial boilers as well.

Direct solar thermal applications for hot water and space heating will probably begin to be more widespread and commonly accepted features of new houses and many older ones in response to increased fuel prices and tax incentives. Some new generating capacity will be added by efficiency improvements in hydropower facilities. In some areas wood or crop residues might become important fuels.

Conservation will probably become very visible during the decade, as industry continues its response to past and continuing domestic oil price increases. Improved energy management techniques and process modifications, e.g., use of energy recovery devices such as recuperators, will gradually become widespread. New consumer durables will become more efficient, in response to consumer demands and regulations and the in-use stock will turn over significantly. Automobiles especially will become dramatically smaller and more efficient, reaching the statutory standard of 27.5 mpg average for new cars in 1985 and probably continuing further.

Davis, Calif.

Rapid progress in making combustion systems less polluting will continue, particularly through controls on automotive engines and the use of scrubbers on new and many old coal-fired facilities. However, we will likely continue to trace the causes of many environmental problems to pollution from energy facilities.

Implementing Actions and Their Status

The most important policies affecting the near-term have to do with providing incentives for production and conservation, removing institutional barriers to new energy facilities, providing insurance against foreign supply disruptions, and continuing to make progress on environmental protection for our energy supply and utilization technologies.

1. Encourage domestic oil and gas exploration and production by insuring realistic prices and a stable price structure for new increments to production.

-- This crucial issue is not now close to resolution.

2. Protect the system from short-term disruptions in oil imports by continuing to develop a large Strategic Petroleum Reserve, and by facilitating diversification of supply sources for the world as a whole and the U.S. in particular. The discovery and production of new oil in developing nations can be fostered by supporting efforts in this direction by multilateral agencies such as the World Bank, and by actively seeking new energy supplies from such countries as Mexico and Canada.

-- Progress is being made on each of these, although more can be done to provide incentives for increased production in the third world by providing technology transfer and offering assistance in developing diversified economies.

3. Push for increased utilization of coal as a substitute for oil and gas by realistic pricing of oil and gas, and by regulations restricting oil and gas utilization in certain types of facilities, especially baseload electric power generation and other large boiler facilities.

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-- Although the regulatory program to mandate coal conversion legislated in the NEA is now in place, continuing oil price controls provide a continuing economic incentive for resistance, and environmental problems may hinder the program's effectiveness.

4. Provide a firm but stable set of regulatory restrictions on coal utilization and production. This applies in particular to sulfur dioxide emissions, strip mining and ash disposal, although particulate emissions and other problems will command continued attention as well.

-- Regulatory proceedings are now underway on the first three issues, but the surface mining rule-making is not being well handled. Particulates have been well controlled for some time.

5. Assure that existing nuclear facilities can continue in operation by beginning to provide, where necessary, away-from-reactor interim storage of nuclear wastes, and facilitate the coming into service of the many reactors now on order or under construction.

-- The Administration has proposed spent fuel storage legislation, although passage in Congress is not assured and requires Administration-wide and White House Congressional support. The Administration is also taking action to diffuse the inhibitory opposition to nuclear power. More could be done rhetorically, although probably not programmatically.

6. Encourage the utilization of available solar energy technologies such as hot water and space heating through provision of tax incentives, federal purchases, information, etc.

-- Substantial tax incentives for solar equipment are provided under the NEA; other options are being considered by the Administration as a part of the Domestic Policy Review on solar energy.

7. Encourage the continuing conservation efforts of firms and individuals. Permitting realistic oil and gas prices is the central policy decision on conservation. Regulatory programs of stringent automobile fuel economy standards, and efficiency standards for household appliances, are also important.

-- Except for oil pricing, each of these is underway.

8. Begin to streamline regulatory processes to reduce delays and increase decisiveness, so that investments in major new energy facilities are not unduly discouraged or unnecessarily delayed.

-- The Administration's forthcoming Regulatory Reform Program and nuclear licensing bill are important. Actions that support innovative and less costly approaches to meeting social goals are also underway in the regulatory agencies, e.g., NRC's generic licensing effort, EPA's bubble concept for air pollution, and FERC's streamlined licensing for small hydropower; many more such reforms are needed.

THE MID-TERM

Early 1990's to 2020's

The Technological Structure

During this period conventional oil and gas supplies will be seriously depleted domestically. Unless dramatic new discoveries are made, foreign production will likely peak as those resources begin to be seriously depleted as well. The continuing rise of conventional oil and gas prices will be slowed by the wider use of synthetics from coal and other supply technologies.

-- Oil imports will remain important early, but the suppliers will probably be diversified somewhat as discoveries outside the Persian Gulf come into play.

-- New gas supplies from Alaska, Canada, Mexico and overseas, same as LNG, may be very important early in the period, but will ultimately decline.

-- Unconventional oil and gas resources could become very important as prices rise and recovery technologies develop. Possibilities include advanced recovery techniques for abandoned oil fields; shale oil, probably using in situ techniques; unconventional gas from coal beds, tight seams, shales, and possibly geopressurized methane; and heavy oil and tar sands in Utah, Alberta, Venezuela, and elsewhere.

Coal will probably be the nation's most important fuel over much of this period. Production will continue rising early in the period.

-- Direct use of coal will continue for electric power production; it will likely also become more widespread as a heat source in industry, possibly with fluidized bed combustion.

-- Facilities for converting coal into liquids and gases may be introduced early in the period and gradually become widespread.

-- The United States could become a major exporter of coal.

Nuclear power will play a very important role principally for baseload electric power.

-- Uranium production will rise in response to nuclear power requirements, with increasing costs as poorer quality ores are utilized (although the effect on the cost of nuclear power will be small).

-- Increased uranium efficiencies in new and existing light water reactors and new enrichment techniques will effectively extend uranium supplies. Further extensions could result from advanced converter reactors introduced later in the period.

-- Nuclear wastes will begin to be disposed of in carefully selected, designed, and operated geological structures.

Solar power and other renewable energy sources will gradually become an important part of the energy system utilized in a number of different ways. Solar hot water, space conditioning, and agricultural and industrial process heating will almost certainly come into widespread use. Photovoltaics could penetrate energy markets beyond the remotely sited installations where it is now used. Alcohol from biomass might come into use early in the period, as may solar thermal power stations and wind systems (in conjunction with energy storage) for electric power by the end. Hydropower could continue to hold roughly its share of electric power supply, depending on the extent to which low-head facilities are installed by cities and factories and new facilities are built as peaking units. Non-exotic geothermal power usage could grow.

Advances in conservation will almost certainly be dramatic, as changes in the utilization of previously available technologies, and wholly new technologies, are incorporated into the economy.

-- Industry will be increasingly efficient as new plants and facilities come on stream using advanced systems designed from the start to be energy efficient.

-- Consumer durables will likely be dramatically more efficient. The most visible changes will be in new automobiles, possibly using advanced engines such as the Stirling and gas turbine. Cars will also be smaller and lighter; two passenger vehicles might be widely used by the end of this period.

-- New housing will be more efficient, well-sealed, and heavily insulated, and will make wide use of passive solar space conditioning.

-- High prices of liquid and gaseous fuels will increasingly limit their uses to particular sectors where they are most advantageous compared to direct use of coal and other substitutes; this applies especially to transportation.

-- Recycling of refuse may become an important source for energy, as well as for other depleted mineral resources.

Changes will occur in the way electricity is used in the energy system, due to the fact that many new technologies most readily produce electricity and advances in technology. For example, electricity could begin to replace liquid and gaseous fuels in some sectors, such as transportation, and time-of-day pricing could induce more careful load management at industrial plants and personal households.

By the end of this century, there is likely to be increasing tension between the objectives of energy supply and environmental protection, as the nation learns more about the environmental impact of its fossil-fired combustion systems and other energy facilities. For example, we will learn more about the extent to which carbon dioxide accumulation will cause climate changes, and the use of combustion-powered energy systems may then have to be controlled through international regulatory programs. Increased knowledge as to the detailed causes and mechanisms for environmental cancers and other health problems will be developed, and some new findings will surely be associated with energy systems. This will result in further pressure for movement away from high pollution energy systems, and concern with mechanisms for balancing risks and benefits in societal decisions will increase.

Implementing Actions and Their Status

The actions needed now to prepare for the transitional mid-term must be directed toward laying the technological groundwork for the adoption of new supply and conservation technologies which conserve conventional oil and gas. There are many activities now underway in the private sector which have the effect of preparing the way for this period. Most significantly, there are a number of new industries which are laying the groundwork for future expansion. These include many associated with solar technologies, such as photovoltaics. Provided that appropriate economic incentives are perceived, it is reasonable to assume that engineers are working on new designs for industrial plants which will in most cases be more efficient. Given the potential profits to be made with new energy ideas, we can count on inventors and entrepreneurs working on new technologies which could play a role in the mid-term, but cannot be described now. Along with the government activities described below, these private sector activities can be counted on to proceed.

1. Take advantage of available gas reserves in Alaska, other Arctic areas, and elsewhere, by facilitating the Alaskan gas pipeline and initiating policy development for other Arctic and non-arctic gas supplies.

-- The Arctic gas pipeline route has been selected and project planning is well underway. FERC and the Canadian NEB are in the final stages of decisions on terms. Present policy with respect to new LNG imports is to not accept them at world prices except in unique circumstances. It may be desirable to change this in the future.

2. Lay the technological groundwork for the exploration and development of unconventional oil and gas resources by: joining with industry to support development and demonstration of enhanced oil recovery techniques; beginning programs with industry for the assessment, characterization, and development of production technology for conventional gas sources, including gas from coal seams, geopressurized methane, and gas in tight sands and oil shales; and supporting industry efforts to develop production capability for shale oil.

-- DOE is proceeding slowly on each of these, perhaps too slowly. We should decide whether oil shale needs any government financial support or not, beyond research and development efforts, and similarly with unconventional gas.

3. Prepare policies and programs for future leasing of coal fields on Federal lands and outer continental shelf oil properties.

-- DOI is presently preparing detailed plans, including leasing criteria, but we continue to have difficulty allowing the private sector access to the public domain.

4. Ensure the laying of the technological groundwork for coal conversion and utilization by sharing with industry the costs of demonstrating well-developed technologies, including coal liquefaction and gasification, and atmospheric fluidized bed combustion.

-- Each large demonstration project is controversial due to economic, environmental and political interests; they are at the margin of the public-private interface, and are very costly. It is unclear that they would not be funded by industry in time to meet the nation's needs, but government support can accelerate them and provide some insurance. We should articulate a policy on this instead of fighting the issue each year at budget time.

5. Support with industry (and in some cases with other nations) research and development on advanced coal conversion and utilization technologies.

-- While there is continual tension over the precise composition of DOE's fossil energy R&D budget, a broad range of coal technologies is being pursued. In the area of advanced options, however, there is real question whether enough is being done. In Congress, especially, work on advanced systems tends to be sacrificed to pay for demonstrations of well-known technologies.

6. Continue research and begin establishment of fair and technically sound regulatory regimes for future coal utilization techniques, including work on sulfates, acid rain, trace metals and organic components in particulates, and coal conversion byproducts.

-- This is crucial work, and is only slowly getting underway. Programs in this area in NOAA, EPA, and DOE, have increased but our needs are very great and growing.

7. Reinforce the confidence of potential buyers of new LWRs by working toward a national concensus on the important role of nuclear power and by implementing the recommendations of the Interagency Review Group on nuclear waste disposal.

-- Quite clearly we have a major political problem here and vigorous Administration leadership is necessary.

8. Continue analysis, and R&D, to prepare for demonstrations of the next generation of nuclear technologies, including more efficient LWRs, advanced converters, and Advanced Isotope Separation Technologies.

-- We have this well underway and we should say so.

9. Join with the private sector in demonstrating relatively conventional solar energy concepts, including agricultural and industrial process heating and solar-powered air conditioning.

-- DOE has this underway.

10. Support R&D on advanced photovoltaic concepts and low-cost photovoltaic manufacturing techniques.

-- The Administration is trying to reorient the photovoltaics program this way, away from Federal procurement, but faces resistance in Congress.

11. Continue to support RD&D on other solar concepts such as wind and ocean thermal energy conversion systems and biomass fuels, and other renewable resources such as geothermal energy. Research should include institutional issues as well as technical.

-- DOE has started programs on these. The biomass program is inadequate in scope and funding and should be reviewed closely in the next budget cycle. Wind and ocean systems need to be reexamined to determine their real contribution.

12. Join with industry to develop advanced conservation technologies, including advanced automotive engines, and bottoming and topping cycles and other forms of waste heat recovery.

-- DOE has reasonable programs in these areas.

13. Encourage increasing energy efficiency, including the use of solar technologies, in the nation's stock of houses, industrial plants, and commercial buildings, by providing a fuel price structure which allows builders to anticipate realistic energy prices in the future, and through regulation where necessary.

-- The oil price regulatory framework we choose now will influence long-term decisions like these; regulations on building efficiency are under development.

14. Continue active research programs to understand carbon dioxide accumulation in the atmosphere and its potential impact, acid rain and other ecological effects of energy facilities, and the sources of environmentally-induced health problems, to identify future regulatory needs.

-- DOE and NOAA are beginning work on the carbon dioxide question; DOE, HEW and EPA are working on health and ecological issues where the effort is rising but more needs to be done.

15. Begin rethinking the nation's approach to environmental regulation, pointing towarded refining, improving and consolidating the regulatory system. This effort should include a more adequate scientific basis for standard-setting, and wide use of regulatory procedures which encourage technological change.

-- This has not yet begun; there remain many scientific and procedural problems which are not being given serious attention.

16. Support an aggressive program of basic research to provide the continuing fundamental insights and advances which can result in continual incremental improvements -- e.g., in materials, combustion, instrumentation, automotive systems etc. -- as well as new inventions.

-- While the national program is strong overall, DOE's basic research program directed toward these ends could be more substantial. Redirection in the FY 80 budget started redressing this. DOT is developing an initiative in automotive R&D which should be supported if it emphasizes basic research in universities and elsewhere.

FAR-TERM

The 2020's and Beyond

The Technological Structure

Conventional oil and gas supplies will certainly be facing serious depletion around the world even at the beginning of this period. Imports of necessity will therefore be greatly reduced from current levels. However, unconventional gas, heavy oils, shale oil, tar sands, and other low grade fossil energy resources will all probably come into development to varying extents, some with advanced technologies minimizing local environmental disruption. As energy prices rise, increasingly less desirable forms of fossil fuel will be exploited, due to physical depletion of lower cost forms.

Coal supplies will face depletion as well, although coal utilization will ultimately fall under competition from advanced solar and other technologies. During the early part of this period advanced coal utilization and conversion technologies will be utilized, including synthetic oil and gas, possibly produced using advanced *in situ* techniques not well developed now such as radio frequency or electrical induction heating.

The nation will increasingly turn to relatively inexhaustible energy supplies, driven by the high cost of depleting fossil fuels, and possibly by environmental problems. They are most likely to produce electricity as an intermediary product. There are three major candidates:

-- Direct conversion systems for sunlight to electricity, such as photovoltaics using advanced materials, photochemistry, or other advanced concepts not now known, are very likely to be prominent. Ultimately such systems might be deployed on satellites.

-- Safe and clean breeder reactors will probably be important early in the period. A system of breeders and advanced converter reactors, based on safe and proliferation-resistant uranium-thorium or uranium-plutonium fuel cycles, would be supportable by thorium and non-fissile uranium resources for many centuries. Fissile uranium would probably be seriously depleted early in this period.

-- Fusion could become an important source of electric power. Many years of large Federal investments might ultimately pay off with a clean power source running on readily available hydrogen isotopes, although widespread usage would probably not take place until the middle of the next century at the earliest.

Other inexhaustible energy sources could also play important roles.

-- The use of agricultural products for conversion into fuel could be important although such use would have to compete with food production for suitable lands.

-- Advanced geothermal concepts, wind and ocean thermal energy conversion might also play significant roles.

-- Hydropower will be limited by the availability of suitable sites, although efficiency improvements and the installation of low-head systems could continue to increase total output. Pumped storage may become more widely used.

Because advanced technologies based on inexhaustible sources are likely to produce electricity as an intermediary product, the nation will turn to new ways of using electricity.

-- The use of instantaneous pricing transmitted along power lines, advances in battery and thermal storage technology, the need to accommodate the diurnal variations of solar power output, and continuing advances in mini-computers, will all stimulate developments in the control and utilization of electric power. For example, household mini-computers may be used to minimize electricity bills through automatic switching of household appliances. Such changes will lower peak-to-base electric power production ratios.

-- Electric power conversion into liquid fuels, probably hydrogen, for use in transportation systems or elsewhere could be important.

-- Electric and hybrid vehicles, using advanced high-temperature batteries such as the sodium-sulfur system, could displace combustion systems for urban delivery and other limited applications.

-- Decentralized electric power generation, with cogeneration, photovoltaics, fuel cells, or other techniques, may reduce dependence on utility grids.

-- Electric power might be transmitted in superconducting lines.

Dramatic energy efficiency improvements in all personal and industrial systems will probably occur, in ways that cannot now be foreseen. These will be implemented in new industrial plants designed from the start to conserve costly energy, especially conventional fuels.

-- Fossil fuel combustion and power conversion systems will probably be made significantly more efficient through the widespread use of new high temperature materials, such as ceramics, as well as relatively advanced concepts such as magnetohydrodynamics and fuel cells.

-- Innovative new techniques for making steel might use, for example, nuclear power rather than combustion.

-- Personal motor vehicles based on advanced concepts such as fuel cells might be widely used, or personal vehicles may become obsolete as efficient and wide-coverage personal rapid transit becomes widespread in urban areas. In general transportation could become less important as communication systems improve, allowing homes and offices to be combined and reducing business travel.

The carbon dioxide problem might become very significant, leading to worldwide controls on utilization of combustion systems and accelerating the trend away from fossil fuels. Moving away from fossil fuels will probably have other beneficial effects on the environment, but the problems of the replacement systems are not now known.

Implementing Actions

To be prepared for this relatively distant period we need to be laying the basic technological groundwork through both fundamental research and the development of some specific systems where technological breakthroughs or major scientific advances are requried. Since the evolution of the technology and society's needs are so uncertain, investigating a broad diversity of relevant approaches is essential.

1. Support basic research in all important scientific disciplines related to energy production, conversion and utilization, including nuclear physics, low-temperature physics, chemical kinetics, solid state physics, materials, environmental processes, and geology.

-- Reasonable efforts across the government are underway in all these areas, but we must continue to press for real growth in this work.

2. Support research efforts on systems operating on essentially inexhaustible resources, especially fusion, breeder reactors and related systems, photovoltaics and other direct solar energy converstion techniques, and geothermal energy. International efforts should be initiated where possible.

-- DOE's programs in these areas need to be reexamined closely for balance and level.

3. Support other advanced systems depending on coal or unconventional gas and oil, and advanced electric power systems, which could offer important advantages, including in situ conversion processes for coal and oil shale, magnetohydrodynamics, superconducting transmission lines, and others.

-- Reasonably strong efforts are underway in almost all of the above areas, but the level of effort needs to be reexamined.

4. Develop a program of detailed assessments of worldwide energy resources, including both unconventional and conventional fuels.

-- There is work underway on this at various public and private institutions, but no thorough and organized program.

GENERAL PRINCIPLES OF AN ENERGY TECHNOLOGY STRATEGY FOR THE UNITED STATES

This vision of the future evolution of the technological structure of the U.S. energy system is in some ways unpleasant. Prices will rise, reflecting real increases in the resources which must be devoted to producing and conserving energy. Yet, the future can continue to be one characterized by sufficient, even abundant, energy supplies. We can adjust to it without undue long-term strain on our economy or our social or political systems. However, this vision is not preordained, and will not be realized unless we act wisely now and through the coming decades. There is an alternative, much less pleasant future. Its essential characteristics could include:

-- continuing increases in demands for decreasing supplies of depleting fossil energy resources, resulting in intermittent physical shortages, with concommitant economic disruption and personal hardships;

-- international tension and intermittent conflict over increasingly valuable fossil energy deposits;

-- government allocation of scarce fuels and a black market with prices well above those of allocated fuels;

-- detailed administrative controls on plant construction, design and operation and on personal behavior in order to conserve and allocate uses of energy to those deemed priority by government agencies rather than individuals and firms;

-- extensive personal hoarding and stockpiling;

-- periodic electric blackouts, as capacity margins shrink due to inability to site new nuclear or coal-fired power plants;

-- stagnation of technological innovation in the energy sector as facilities using new technologies are not permitted without proof positive of environmental benignity.

In short, this future involves a gradual but inexorable decay of the energy supply system as we now know it.

If such collapse seems imminent, pressure will mount to abandon the essential structure of that portion of our economic, regulatory and political system which deals with energy. Government will be forced to intervene massively and preemptively into energy supply, allocation and utilization. Existing institutions and procedures designed to protect the environment will come under great pressure. Major new government entities, including a bureaucracy for allocation and institutions for mobilizing large amounts of capital, would replace the private institutions now in place.

However, the nation need not follow this undesirable path. Our nation is the envy of the world for its ability to create and respond to technological opportunities. Our basic economic system is vigorous and robust. It adapts over time to changing resource availability. There is no reason to believe that, if it is given the legal leeway and realistic economic signals, it will not adapt to the changing energy situation. What is required, beyond the maintenance of a strategic petroleum reserve, is the adoption of an energy technology strategy built around the following three principles:

1. The price system should reflect the real cost of new energy supplies. Prices are the signals to which private sector decisions to develop or utilize new energy technologies and to consume less of the conventional supplies respond. Any energy price held below its market value not only encourages waste in the short-run, but also delays the necessary technological restructuring of the energy system.

2. We should maintain adequate environmental and safety controls, but within a streamlined procedural system. The environment and the people must be protected from the dangers posed by energy systems. But the nation must do so in a manner which is as cost-effective and as decisive as possible. The alternative is delays in the installation of new plant and facilities -- including power plants, pipelines, and refineries -- with increased imports of oil and gas, exports of refining capacity, and uneconomic investments in inefficient energy systems (e.g., gas turbines for electric power).

3. The government should continue aggressive development of a wide range of new energy technology options. It is the government's duty to play an important role in the development of new energy technologies, supplementing the development efforts of the private sector, and helping to support technological change.

At the present time, our energy RD&D program is generally a sound one. This has not been enunciated to the public. There are some difficulties with management and project selection in certain areas of DOE's program, especially an inappropriate emphasis on demonstrations of reasonably well-known technologies as compared to development of more risky advanced systems and basic research. The blame for this must be given largely to the Congress. However, the program is generally an aggressive one on a wide array of important technologies.

However, there are fundamental disagreements over the technology strategy principles which would allow the energy system to adjust to the continuing depletion of conventional fuels. Differences in perceptions, values, and interests, have led to policies on petroleum pricing and environmental protection which may have outcomes unsatisfactory to almost everyone. If we are to attain a reasonable evolution of the energy system we must allow domestic oil prices to reflect those in the world market, and we must begin to reform our regulatory procedures.

ID 791138 THE WHITE HOUSE

WASHINGTON

DATE: 26 MAR 79

FOR ACTION:

INFO ONLY: THE VICE PRESIDENT HAMILTON JORDAN

FRANK MOORE (LES FRANCIS) JODY POWELL

ANNE WEXLER CHARLIE SCHULTZE

ALFRED KAHN

SUBJECT: EIZENSTAT MEMO RE CRUDE OIL PRICING OPTIONS

++++++++++++++++++ ++++++++++++++++++ ++++++++++++++++++

+ RESPONSE DUE TO RICK HUTCHESON STAFF SECRETARY (456-7052) +

+ BY: +

++++++++++++++++++ ++++++++++++++++++ ++++++++++++++++++

ACTION REQUESTED: YOUR COMMENTS

STAFF RESPONSE: ( ) I CONCUR. ( ) NO COMMENT. ( ) HOLD.

PLEASE NOTE OTHER COMMENTS BELOW:

THE WHITE HOUSE

WASHINGTON

March 26, 1979

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MEMORANDUM FOR THE PRESIDENT

FROM: STU EIZENSTAT
KITTY SCHIRMER

SUBJECT: CRUDE OIL PRICING OPTIONS

This memorandum sets out the nature and effects of three options for domestic crude oil pricing.

The major differences between the options relate to:

- o whether our policy goal for decontrol should be September 1981, or some later date;
- o if 1981 is selected as the target for decontrol, whether you should leave the door open to make continued progress toward full decontrol contingent on enactment of a tax;
- o the level and mechanism of avoiding protection against the effects of future price increases on consumers and economic growth; and
- o the inflation effects which the economy and your anti-inflation program can tolerate over the next several years.

THE OPTIONS

The basic elements of each of the options are described below.

1. The Eizenstat/Kahn Option:

- o extends controls on some oil beyond September 1981, with statement that you intend to move toward full decontrol when economic and inflation circumstances permit. (A specific target date of the end of 1983 could be given although Kahn recommends against a particular date since this lessens the palatability of this option to labor and others who we are trying to woo in the anti-inflation program.) Submit legislation to extend EPCA in 1981.

- Takes immediate administrative step to increase supplies by establishing a $16.00 market incentive price for newly discovered oil, production (on a phased-in basis) from marginal wells, and new production from enhanced recovery projects. This incentive price, currently above the OPEC posted price, provides a significant incentive for new production. (It is roughly equal to the current landed price of imported oil.)

- Retain controls on lower and upper tier oil which does not qualify for the market incentive price. For lower tier oil, however, the decline rate and other technical aspects of current regulations would be adjusted to remove existing production disincentives.

- Seek legislation establishing an "OPEC" tax which would be equal to 75% of the difference between the $16.00 market incentive price and the world or OPEC price of oil. If this tax were enacted, the market incentive price would be abolished, and any oil eligible for that incentive price would receive world prices.

- Revenues from the tax, if enacted, would be used to cushion the impacts of price increases on the poor and for an Energy Fund devoted to providing long term solutions to the energy supply problem. This feature is common to all of the options.

2. The McIntyre Option:

- State intent to decontrol fully by 1981 and outline the path you intend to follow. Take the same first steps as contained in the Eizenstat/Kahn Option (namely establishment of a market incentive price for newly discovered oil), marginal wells (on a phased basis), and production from enhanced recovery projects.

- The path to decontrol proceeds upward on January 1, 1980 toward thw world price faster than the Eizenstat/Kahn approach. Your commitment to decontrol by 1981 is absolute only if Congress passes tax legislation. If Congress fails to pass a tax, you retain the option of slowing down (or stopping) decontrol, or proceeding to 1981 decontrol anyway, depending on your judgment at that time.

- Propose an OPEC tax to Congress which taxes 75% of the difference between the tax base ($16.00) and the prevailing world price. (Note: This is identical to the Eizenstat/Kahn tax.) Also propose a "decontrol tax which would tax about 40% of any increase resulting from decontrol of upper tier oil.

- A portion of the tax revenues (if enacted) would be used to assist the poor. The remainder would be used for an Energy Fund directed toward long-term solutions to the energy problem.

3. The Schlesinger/Blumenthal Option:

- Phases out price controls on all domestic oil on a relatively smooth path between June 1, 1979 and September 1981. Actions to be taken include:

  -- Providing the world price for newly discovered oil immediately.

  -- Phasing in price increases for marginal wells from the lower to the upper tier.

  -- Making changes in lower tier (as in the Eizenstat/Kahn approach) to eliminate production disincentives.

  -- Phasing the upper tier price to the world price beginning on January 1, 1980.

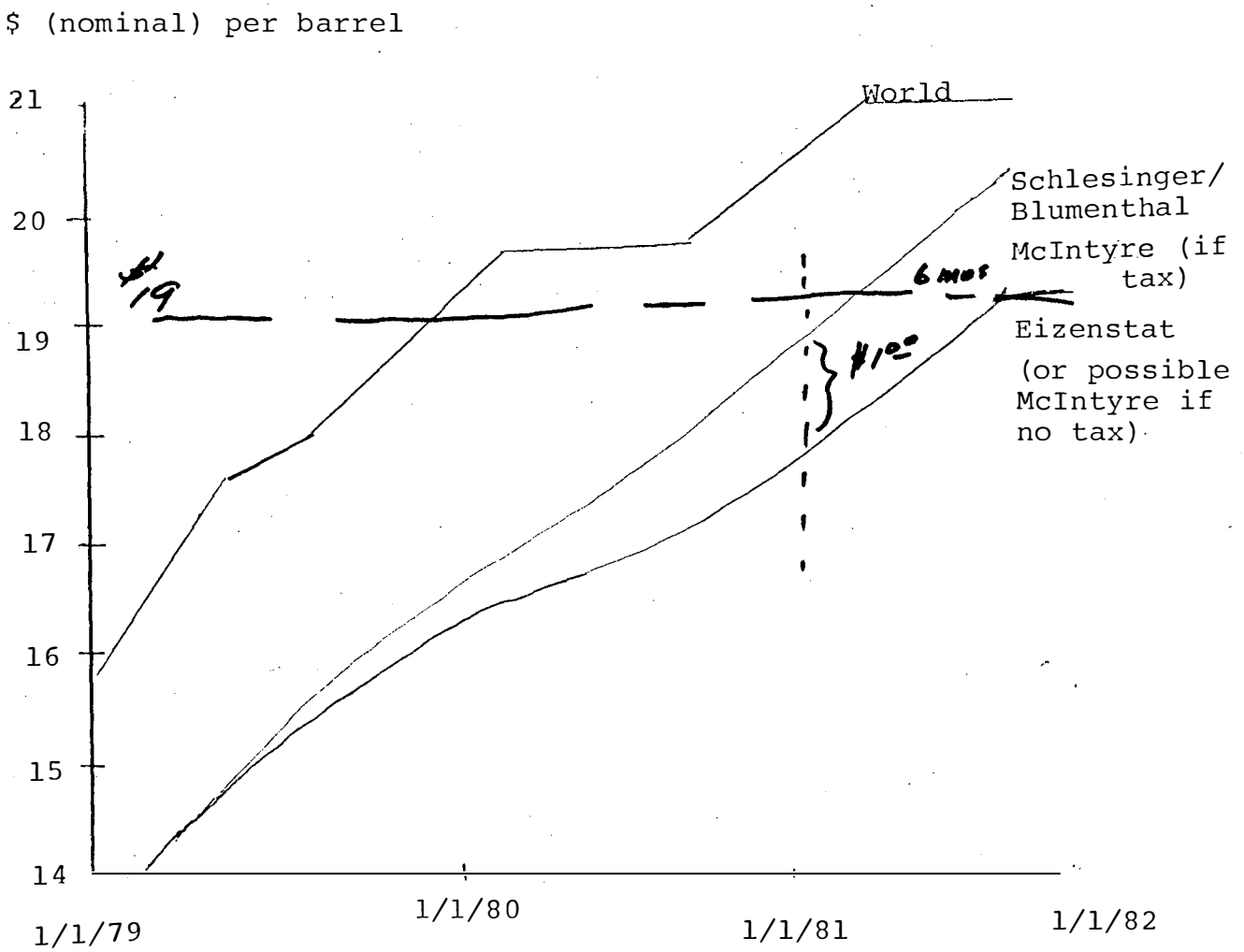
- Work with Congress to develop a tax which captures a large percent of future increase in the OPEC price and, in addition captures some of the extra producer revenues resulting from decontrol.

- Tax revenues, if available, would be used for the poor and an Energy Fund.

- Decontrol would occur regardless of Congressional action on the tax.

The following chart shows a rough approximation of the price paths which domestic oil prices would follow under these three approaches.

Summary of oil pricing impacts



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IMPACTS OF THE OPTIONS

The macroeconomic impacts of the three options are estimated in the following tables. These numbers are only indicative and should not be read as precise reflection of the actual impacts.

TABLE I

%Annual change in the Consumer Price Index (assuming $1.50 further increase in OPEC prices in 1979, but no further real increases)

	1979	1980	1981	1982
Eizenstat/Kahn				
- with tax+	.05	.19	.20	.15
- without tax	.05	.15	.15	.12
McIntyre				
- with tax	.05	.25	.30	.20
- without tax*	.05	.15	.15	.12
Schlesinger/Blumenthal				
- with tax	.05	.25	.30	.20
- without tax	.05	.25	.30	.20

*Assuming that controls were reimposed if Congress fails to enact a tax.

+Note: Since chance of enactment of the tax are slim under this (and the other option), the most instructive base for comparison is the "without tax" line.

TABLE II

Reduction in Growth Rates
(assuming a $1.50 further OPEC price increase in 1979, but no real price increase thereafter)

	1979	1980	1981	1982
Eizenstat/Kahn				
- with tax	-.03	-.21	-.23	-.11
- without tax	-.03	-.12	-.15	-.09
McIntyre				
- with tax	-.03	-.17	-.20	-.16
- without tax*	-.03	-.12	-.15	-.09
Schlesinger/Blumenthal				
- with tax	-.06	-.19	-.23	-.16
- without tax	-.06	-.24	-.26	-.18

*Assuming that controls are reimposed if Congress fails to enact a tax.

TABLE III

INCREASES IN PRODUCER REVENUES (AFTER INCOME TAXES & OPEC TAX)
(assumes a $1.50 further OPEC price increase in
1979, but no real price increase thereafter)

(in Billions, nominal $)

	1979	1980	1981	1982	1983	1984	1985	1979-1985
Eizenstat/Kahn								
- with tax+	0.5	2.1	3.7	5.0	6.0	6.4	6.1	29.8
- without tax+	0.5	2.2	3.8	4.9	5.9	6.3	6.2	29.8
McIntyre								
- with tax	0.5	2.6	4.9	7.1	6.7	6.4	6.1	34.3
- without tax*	0.5	2.3	3.8	4.9	5.9	6.3	6.2	29.9
Schlesinger/ Blumenthal								
- with tax	0.9	3.0	5.4	7.1	7.0	6.9	6.9	37.2
- without tax	0.9	3.4	6.2	8.9	8.8	8.6	8.6	45.4

*Assuming controls were reimposed at the Eizenstat/Kahn level. Depending on your decision at the time, producer revenues could go a high as those in Schlesinger/Blumenthal without tax.

+The reason that these two lines are similar is the OPEC price assumption -- no real increase after 1979. The $16.00 market incentive price is close to the 1979 OPEC increase assumed in the base. If OPEC prices were to increase in real terms after 1979, producer revenues without the tax would be lower than with.

It is critical for you to understand that each of the preceding tables assumes a $1.50 OPEC price increase in 1979, but no real OPEC price increases beyond 1979. This methodology masks much of the real difference between the options -- which have significantly different effects the higher the OPEC price increase goes. The following chart illustrates the differences between the options if one chooses a different (and many feel more likely) set of OPEC pr-ice increase assumptions, namely a 10% real increase each year after 1979.

TABLE IV

	% CPI Increases			Producer Revenues		
	1980	1981	1982	1980	1981	1982
Eizenstat/Kahn						
- with tax	.49	.55	.50	.4	.5	.6
- without tax	.45	.45	.42	1.5	1.5	1.6
McIntyre						
- with tax	.65	.75	.70	1.5	1.5	1.6
- without tax*	.45	.45	.42	.4	.5	.6
Schlesinger/ Blumenthal						
- with tax	.65	.75	.70	.8	.9	1.0
- without tax	.65	.75	.70	1.5	2.5	4.3

The final chart, below, sets out estimated increases in Federal tax receipts which would occur if the OPEC tax were enacted. In all of the options, the proceeds of this tax would be used to offset the impacts of higher energy prices on the poor, and the remainder used for an Energy Fund to finance projects which we cannot now afford. Examples are: SRC I (for coal), loan guarantees for other coal gasification projects, development of gasoline substitutes, solar and renewable energy R, D, & D, and perhaps, additional tax credits for conservation

*Assuming that controls are reimposed if no tax.

investments. Everyone strongly believes that an emphasis on new technology is essential to giving some hope that there is a way out of this problem.

TABLE V

Federal Tax Receipts
(billions of current dollars)
(Calendar Years)

	1979	1980	1981	1982	1983	1984	1985
Eizenstat/ Kahn	0.3	1.7	2.7	3.5	4.2	4.4	4.6
McIntyre	0.3	2.1	3.0	4.0	4.3	4.4	4.6
Schlesinger/ Blumenthal	0.3	1.2	2.4	4.1	4.0	3.9	3.8

*Schlesinger/Blumenthal receipts are lower in some years because the tax under their option does not apply to Alaska North Slope oil, newly-discovered oil, or incremental production from tertiary projects. Schlesinger and Blumenthal do not believe there is any chance of enacting a tax on ANS oil.

DISCUSSION

1. The Eizenstat/Kahn Option

Pros

- Provides a supply response similar to the other options, at least in the first 3-4 years (assuming no substantial OPEC price increases). It provides this supply without giving producers the additional increased revenues conferred by the other options or incurring either the actual or psychological impacts of added increases to the CPI. Achieves only slightly less restraint in demand which would result from price increases in the other options (i.e., less than 100,000 bbl/d difference in 1981).

- Such a program can appear just as bold and decisive as a decontrol program since you are announcing a willingness to give very generous price increases where it will yield new supplies, but a resolute unwillingness to give unnecessary windfalls to producers.

- Provides maximum protection for your anti-inflation program while still giving producers needed incentives. Fred Kahn is convinced that any program which embraces full decontrol, however carefully phased in, will be the last straw for organized labor. This would effectively kill any remaining chances that the anti-inflation program may have.

- At a time when significant elemnets of our base within the Democratic Party are disaffected because of budget cuts, decontrol may be the last straw for them as well. While likely to draw some criticism from the left, this approach at least gives you a leg to stand on with consumer/labor/Northeastern interests. You have not embraced full decontrol, and you have provided only those incentives needed for maximum domestic production.

- This is the only option that gives you strong protection against signficant future OPEC price increases (though it requires extending controls beyond 1981 to continue to provide that protection). The establishment of a market incentive price cap is a strong statement that the U.S. is not willing to automatically follow OPEC prices, no matter how high they might go. It avoids having to explain why we become more independent of OPEC by tying our price structure to theirs. It is important to remenber that OPEC prices are not based upon the cost of producing oil and are not, in any sense of the word, free market prices. They are monopoly prices, and decontrol without a tax would unarguably permit U.S. producers to enjoy the benefits of full participation in the cartel.

- Some independent producers will support this approach. Representatives of independents have told us that they would prefer "less decontrol if it is not contingent upon a tax than greater or even full decontrol if it is contingent". Even if this group witholds its full support, they seem to be willing to give you credit for taking the right first steps.

- Puts you in a strong position if the tax fails, as many believe is likely even under the best of circumstances. You are not forced into a position of either changing direction in mid-stream, or granting, through implementation of decontrol revenues to producers which you yourself had defined as windfalls at the time the tax was requested. Both the American consumer, and your political interests are better protected.

- Is less disruptive of certain elements of the oil industry such as refiners, resellers, and jobbers.

Cons

- Requires an extension of the control authority in the Energy Policy and Conservation Act (EPCA). Undoubtedly, the legislative battle over EPCA will be bruising, but Stu and Fred believe that it need not begin until 1981. Jim Schlesinger and Mike disagree, and also believe that this package is not generous enough to prevent Congress from eating away at your control authority on a piecemeal basis. Stu and Fred disagree with this judgment since the package contains the very elements recommended by Wright, Bentsen, and others.

- Maintains the entitlements and the price control systems after 1981. All agree that these regulatory systems, often described as an administrative nightmare, are cumbersome and complex.

- Withdraws from the Bonn commitment and disappoints our Summit allies as well as moderates within OPEC. Blumenthal. who deals on a daily basis with foreign economic officials and the dollar markets, strongly believes that continuation of controls would have major negative diplomatic and exchange market effects. A negative impact on the dollar could, in turn, exacerbate domestic inflation. Henry Owen adds that at the Summit Preparatory Group meeting in Tokyo last week, the British, French, German, and Japanese delegates took the initiative in stressing the importance their governments attached to the Bonn Commitment in relation to the world energy problem. They asked for a progress report at the Tokyo Summit. (Fred and Stu would note that to the extent that decontrol

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were seen as feeding an already out-of-control inflation rate, and especially if it were to lead to an outbreak of wage increases above 7%, this would have a negative impact on the dollar. Assessments of impacts in this area are difficult.)

- o It may draw heavy criticism from both sides of the political fence: from producers for not advocating decontrol, and from liberals who oppose any price increase. Blumenthal and Schlesinger believe that it risks falling between the stools politically.

Hold down production of old oil?

- o In Jim Schlesinger's, Jim McIntyre's, and Mike Blumenthal's view it is the least likely of the options to result in Congressional enactment of a tax. Liberals will oppose the tax in order to prevent any further decontrol; producers will oppose on principle.

- o Failure to decontrol by a date certain may weaken production incentives after 1981, and Jim Schlesinger, Mike, and CEA believe that this would contribute to larger OPEc price increases. They also point out that to the extent that demand is not restrained as much under this option as under decontrol, our dependence on OPEC would increase as would U.S. exposure to higher OPEC prices.

2. The McIntyre Option

Pros

- o It sets out a definite and clear path toward decontrol by 1981, and takes the first steps toward that end. It puts the monkey clearly on Congress' back in determining whether they want to assure that the decontrol process will move forward.

- o Retains flexibility to respond to the energy, economic, and political circumstances prevailing in January, 1980 if Congress has failed to give you an adequate tax. At that time you may reimpose controls or continue to decontrol depending on the outlook at that time.

- o It maximizes the changes of getting a tax by providing both a carrot (new programs and projects through the Energy Fund) and a stick (the threat of not continuing down the decontrol path without a tax). It does not require Congress to take the first step to raise prices since you have already made that move. While it may write off many of the liberals, they are going to oppose a tax under any of the options.

- o It has all of the substantive advantages of the Schlesinger/Blumenthal option, and some of the political advantages of both other options. It maintains your Bonn pledge, albeit with conditions.

Cons

- o Jim Schlesinger and Mike Blumenthal believe that it will damage the chances of passing a tax. It gives liberals a reason to oppose the tax while conservatives and producers will call the bluff realizing that they may be able to escape controls in 1981. As such, it may have even greater risks of falling between the stools politically.

- o Sets up a political squeeze play in early 1980 if Congress fails to enact an adequate tax. Liberals will demand new controls while conservatives and international allies will say new controls are an economic catastrophe. You will enter the primaries having to make a potentially party-splitting decision.

- o Can be construed as less decisive than the other two options, although by making a firm economic case for the need for a tax this problem might be mitigated. It does, however, throw future oil prices into a nine month period of uncertainty.

- o Members of Congress have uniformly advised that making decontrol contingent upon enactment of a tax pressures would kill any chance for a tax by giving liberals strong reason to oppose a tax. Jim McIntyre feels that your taking the first step toward decontrol without waiting for a tax may reverse the contingency enough to mitigate this problem.

3. The Schlesinger/Blumenthal Option

Pros

- o States a clear policy direction toward decontrol in September 1981 with no hedges or caveats. Creates certainty for energy prices, and maximizes post-1981 production incentives. Puts the decontrol issue behind you as a major divisive political issue.

- o Puts maximum pressure on liberals and moderates to support a tax since they have nothing to gain by holding back support.

- o Is consistent with the Bonn pledge and assures U.S. leadership among oil consuming nations (especially at the Tokyo Summit and in the International Energy Agency). Will be praised by our allies.

- In Jim, Mike's and CEA's view, provides the strongest and clearest signal to OPEC and the rest of the world that the U.S. is serious about controlling energy use. This may lower the rate of future OPEC price increases.

- Is likely to strengthen the dollar, which provides its own anti-inflation benefits. Through providing maximum production incentives in the mid-eighties, it holds a significantly higher prospect of reducing oil imports and thereby the trade deficit in that timeframe. (Supply response is similar to other options in the short run, if OPEC prices remain constant.)

- Realizes the goal of replacement cost pricing stated in the National Energy Plan of April 1977.

- The pricing part of the Option will receive strong producer support, although the independents, and probably the majors, will fight the tax as hard as they can.

- Permits certain elimination of the entitlements and the regulatory system in September 1981.

- Mike and Jim believe it is decisive and shows leadership, and will be applauded by major informed media, i.e. New York Times, Washington Post.

- Schlesinger and Blumenthal believe that the differences in inflation effects between the options are miniscule, highly conjectural, and subject to significant error. They disagree that chosing decontrol will significantly effect the wage/price program.

Cons

- Fred and Stu believe that this may be the final nail in the coffin of the anti-inflation program. Will be strongly opposed by organized labor, consumer groups, and liberals in Congress.

- Ties U.S. oil prices to the OPEC price after 1981 whether or not a tax is enacted. With substantial OPEC increases in the future, the economic impacts of this approach could be very adverse. Can be seen as increasing our exposure to "economic blackmail" by OPEC.

- o Minimizes the likelihood of producer support for a tax. If decontrol will happen anyway, why bother? Producer support for a tax under any of the options is unlikely, however.

- o Without Congressional enactment of a tax, the President will be in the position of giving to producers the very windfalls he stated he would like to avoid. Up until September 1981, the President retains authority to reimpose controls in whatever manner he desires and pressure, particularly during the primaries, to do so will become intense. This sets up an even more bruising political squeeze play since it will be difficult to pin the entire blame on the Congress when it remains within the President's power to rectify inequities.

- o Will not produce significant added supplies of domestic oil relative to the other options, at least in the short run. (If OPEC prices were to increase dramatically in the short run, the supply effects of decontrol would be greater.)

- o Is likely to be extremely costly from a political standpoint in the Northeast, Midwest, and Mid-Atlantic states. Consumers from producing states will also oppose decontrol.

- o Could hurt the dollar if international exchange markets believe inflation is more important than energy, and decontrol is seen to feed inflation. Particularly if decontrol is in fact the fatal blow to the inflation program, a failure of our anti-inflation efforts could have substantial and sustained negative impacts on the dollar.

RECOMMENDATIONS

The Eizenstat/Kahn option is recommended by its authors.

The McIntyre option is recommended by its author.

Secretary Vance, NSC, and Henry Owen recommend, with Jim and Mike, the Schlesinger/Blumenthal option.

C

THE WHITE HOUSE

WASHINGTON

March 26, 1979

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MEMORANDUM TO THE PRESIDENT

FROM: ALFRED E. KAHN Fred

SUBJECT: The Eizenstat-Kahn Option on Energy Policy in Relation to the Alaskan Swap

I know you have heard all the arguments, and I would therefore have refrained from adding these pieces of paper to the pile before you, except that I emerged from our meeting of last Friday dissatisfied with our virtual dismissal of the Alaskan swap in our consideration of the major options before you.

I think it fair to say you were left with the general impression that the way to exert strong Presidential leadership necessarily embraces decontrol of crude oil, while postponing taking a position on the Alaskan swap. I suggest, respectfully, that you can exert and demonstrate at least equally strong leadership by firmly stating the following:

1. That we are determined to take every step available to us now to increase domestic supplies of oil (and of other forms of energy). It was generally conceded at our Friday meeting that the steps proposed in Stu's and my option are all the ones that can be expected to have a substantial short-run influence on oil supplies (except for the swap). But,

2. You will not expose the American people to unnecessarily onerous burdens by decontrolling the production of oil that has already been discovered and developed, without any assurance of a tax that would extract at least a major portion of the resulting windfalls and that would permit us to finance measures that would provide relief to the people of modest income who would be seriously injured by simple decontrol.

3. As a part of your determination to do everything possible to remove he impediments to expand domestic oil supplies, you will insist that Congress eliminate the export prohibitions that now prevent the Alaskan/Mexican oil swap;

this step alone will do as much to induce additional domestic production as all the other measures taken together.

I find totally incomprehensible the argument by the advocates of the Schlesinger-Blumenthal option that you must show firm leadership in declaring for decontrol -- regardless of what this will do to the willingness of the American people to adhere to your wage and price standards and their perception of the fairness of your entire anti-inflation program, even though it brings little or no additional supplies compared with Stu's and my option -- but that you do not dare to press forthrightly for the swap.

You heard the reports from Stu and Frank Moore about the strong assertions by Senators Bumpers, Long, Bentsen, Church, and Ford that there is no reason in the world that the American people cannot be made to understand why the swap is important and obviously desirable. (I must defer to them for a fuller assessment of the likelihood of Congressional action.)

By asking Congress to remove the export ban only for additional supplies, over and above the present 1,200,000 barrels a day, you can (a) undercut the argument that the swap would (like general crude oil decontrol) merely confer additional profits on the oil companies for a production that is already available to us, (b) avoid discouraging construction of the Sohio pipeline, and (c) avoid having to fight the maritime unions, who would be expected to oppose a total elimination of the export prohibition. I would, of course, prefer to have the export prohibition totally eliminated, but since we are basing our advocacy simply on the need for additional domestic supply, removing it for incremental production will suffice for present purposes.

To the extent that this memorandum repeats arguments I have already made, I sincerely apologize.

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EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

C

MAR 26 1979

MEMORANDUM FOR: THE PRESIDENT

FROM: James T. McIntyre, Jr.

SUBJECT: Crude Oil Pricing

In advance of our Tuesday morning meeting, I wanted to give you my private views as to why I believe you should adopt a somewhat flexible course on this matter.

At our meeting on Friday, I was impressed with your desire above all to do what is right for the nation. For all of the reasons which Mike Blumenthal, Jim Schlesinger and Warren Christopher mentioned, I am persuaded that full decontrol of oil prices by 1981 is the right course for the nation. But for reasons of overall energy policy, economic policy and simple equity, it is the right course in my judgment only if the Congress enacts a tax. If the Congress fails to enact a tax, it could well turn out to be the wrong course for the nation and the wrong course for you politically.

With the revenues from a tax, we can alleviate the impacts of oil price rises on those who can least absorb them. With an Energy Fund financed by a tax, we can undertake exciting energy research and development efforts which we otherwise could not afford.

Without a tax, on the other hand, but with full decontrol, we cannot protect the most vulnerable U. S. citizens against future OPEC price increases; we cannot insure that U.S. companies will not profiteer as a result of OPEC actions; and we cannot provide the financing for an Energy Fund.

If the Congress fails to enact a tax, not only will considerations of equity, economics and energy policy require that you have the flexibility to reimpose controls if conditions warrant, political and moral considerations also will require that you be able to exercise that flexibility without going back on your word.

The option which I have suggested to you (full 1981 decontrol with a reverse contingency) maximizes, I believe, the chances of getting a tax. The objections raised in our House and Senate consultations to the earlier option of full and immediate decontrol only when Congress enacted a tax

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focused on (1) the economic shock of immediate decontrol, and (2) the fact that the Congress would have to vote before you took a first step. My option deals with both of those objections.

At the same time, my option preserves your flexibility without taking the heat off the Congress. Two of the principal rules of politics to me are (1) a lot can change in a very short time, and (2) irrevocable decisions should not be made until absolutely necessary.

EYES ONLY

C
—

THE VICE PRESIDENT
WASHINGTON

March 26, 1979

MEMORANDUM FOR: THE PRESIDENT

FROM: THE VICE PRESIDENT

SUBJECT: CRUDE OIL PRICING

Dick Moe filled me in on the meeting last week and Stu gave me an opportunity to review his draft memorandum to you. The following are a few brief points I would like to make as you approach your final decision.

Throughout our deliberations on this issue, five conclusions are inescapable based on the best information the agencies and staff have gathered:

o Total decontrol of crude prices provides extremely small oil import savings when compared with a more targeted set of production incentives;

o For these modest import reductions, the public would be asked to pay a substantial price both in near-term inflation impacts and in revenue transfers to the oil companies;

o The decontrol options pose even greater inflation and equity problems if OPEC seeks substantial price increases over the next several years;

o We cannot count on the ability of Congress to reach agreement on a tax and rebate mechanism to offset these impacts; and,

o In the absence of a tax/rebate mechanism, we have no defense against charges of outrageous windfalls and we run a high risk that organized labor will abandon all cooperation with the guidelines program.

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Based on these conclusions, I believe we should go with the Eizenstat-Kahn option. It allows us to be aggressively pro-production, while opposing unnecessary inflation. It achieves all of the import savings we can responsibly accomplish over the next several years. And it does not depend upon Congressional action for its success.

Far from an appearance of timidity or weakness, I believe that the Eizenstat option puts you in the strongest possible posture given the complexities of this issue.

It would enable you to rightly say that you had rejected pressures for an all-or-nothing approach, or for an approach that shifted the responsibility for the consequences of this decision to the Congress.

It would enable you to say that you have done everything you reasonably can to stimulate new production.

And it would enable you to say that as much as you would like to dismantle the controls machinery, equity for the public and success in the fight against inflation must come first.

THE WHITE HOUSE

WASHINGTON

March 29, 1979

MEMORANDUM FOR THE PRESIDENT

FROM STU EIZENSTAT
KITTY SCHIRMER

SUBJECT: CRUDE OIL PRICING

Following up on our Tuesday morning meeting, we have developed specific options for:

- a schedule for decontrol by 1981
- tax proposals targetted both on increases which may result from future OPEC actions, and revenues which would accrue to holders of old oil;
- proposed uses for the revenues which:
  - -- assist the poor
  - -- supplement current mass transit funding
  - -- create an energy fund for projects which we cannot otherwise afford.

We have reached agreement among ourselves in the last two areas. There continues to be disagreement about the optimum schedule for decontrol. Fred Kahn, Jim McIntyre and I continue to believe that this schedule should be backloaded to the maximum extent possible in terms of its inflation effects and transfer of revenues to producers. Jim Schlesinger and Mike Blumenthal support a phase-in schedule which is considerably more heavily front-loaded.

We have also explored possibilities for actions which would limit oil company investments outside the energy area, or otherwise demonstrate distance between them.

The options and recommendations are outlined below:

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EOR = Enhanced oil recovery

I. THE DECONTROL SCHEDULE

Option A: Back-Loaded Administrative Decontrol

- Newly discovered oil receives the world price 5/1/79
- Production defined as "marginal" under the Wright proposal is released to the upper tier price according to the following schedule.

World - 18%
upTier - 12 20
Lower - 5 80

40% on 5/1/79
20% on 5/1/80
20% on 5/1/81
20% on 10/1/81

- Non-marginal lower tier oil receives updated BPCL's, erasure of cumulative deficiencies and the following decline rate schedule. -?

2% per month 5/1/79 to 5/1/80
3.5% per month 5/1/80 to 5/1/81
6% per month 5/1/81 to 10/1/81

- Incremental tertiary production receives the world price.
- The upper tier price increases linearly from 1/1/80 till it reaches the world price 10/1/81.
- Controls expire 9/30/81.

Option B: Gradual Administrative Decontrol

- Newly discovered oil receives the world price 5/1/79.
- One hundred percent of the production defined as "marginal" under the Wright proposal is released to the upper tier price on 5/1/79.
- Non-marginal lower tier oil receives updated BPCL's, erasure of cumulative deficiencies, and a 2% per month decline rate.
- Lower tier properties which already have tertiary projects in place (1/1/79) will receive a 3% per month decline rate.

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- The upper tier price increases linearly from 6/1/79 till it reaches the world price on 10/1/81.

- Incremental tertiary production receives the world price. To finance certain enhanced oil recovery projects, producers would be permitted to release limited volumes of lower tier oil to the upper tier price as partial reimbursement for the production investment. Revenues from this mechanism could not exceed $20 million per project or $2.25 billion from 7/1/79 to 10/1/81.

- Controls expire 9/30/81.

The following charts show the overall price path which these two options would generate, and the macroeconomic impacts, producer revenues, and estimates supply impacts of the options.

CHART I -- see page 3a

CHART II

FURTHER MACROECONOMIC IMPACTS ASSUMING
$1.50 OPEC INCREASE IN 1979, AND
NO REAL OPEC INCREASES THEREAFTER
(percentage points)

Impacts on:	4 qtrs of 1979	1980	1981
Inflation			
Option A - Back-loaded	+.10	+.19	+.29
Option B - Gradual	+.17	+.23	+.24
Growth			
Option A - Back-loaded	-.11	-.17	-.26
Option B - Gradual	-.16	-.23	-.20
Unemployment Rate			
Option A - Back-loaded	-.04	-.10	-.20
Option B - Gradual	-.05	-.14	-.23

Price Trajectories for World and Domestically Produced Oil

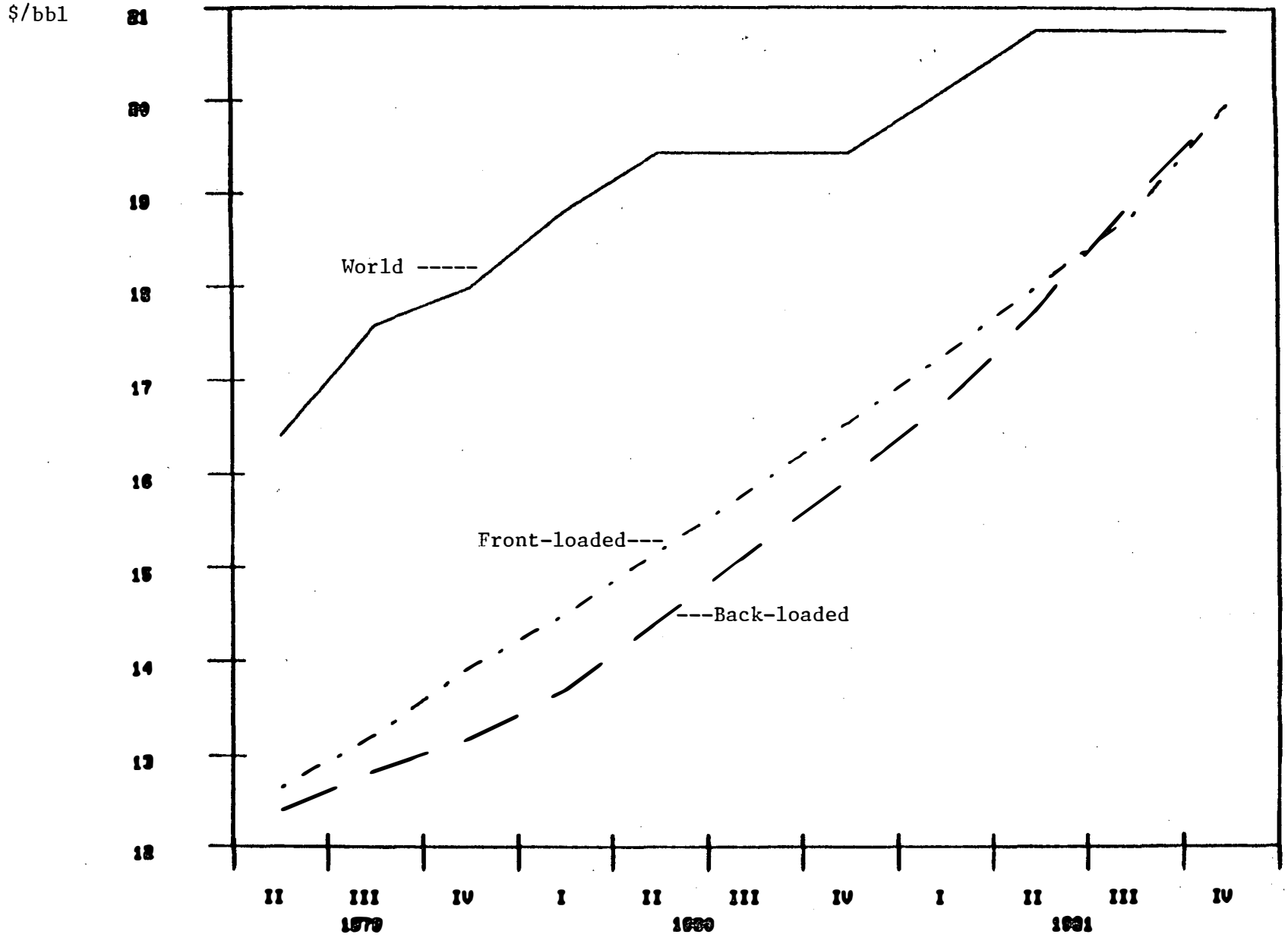

CHART III

INCREASES IN PRODUCER REVENUES BEFORE AND AFTER TAXES (INCOME AND NEW TAXES)

	1979	1980	1981	1982	1983	1984	1985
Option A							
Before taxes	0.8	4.7	11.6	14.8	14.6	14.4	14.3
After taxes	0.4	1.7	4.2	5.6	5.8	5.8	5.8
Option B							
Before taxes	2.9	7.8	14.0	14.8	14.6	14.4	14.3
After taxes	1.6	3.2	5.5	5.7	5.8	5.8	5.8

CHART IV, on the following page, show supply effects of the options.

II. TAX PROPOSALS

Two taxes are recommended to be proposed with either of the schedules for phased decontrol. One tax is targetted to increases in producer revenues which would result from future OPEC increases, the other is a "decontrol tax" on old and upper tier oil. The two taxes are described below.

1. The OPEC tax:

The Secretary of the Treasury would set a base price equal to the average landed price of imported oil as it would be in the schedule announced by OPEC in December 1978. The Secretary would adjust this base price for inflation each quarter. A tax would be imposed on all oil selling at the world price (except oil from the Alaska North Slope) which would be equal to 50% of the difference between the base price set by the Secretary and the prevailing world price. The tax would become effective on the date of enactment.

2. The Old & Upper tier tax:

Old oil (except that qualifying for marginal well treatment) would be subject to a tax on any volumes above a 2% per month decline rate which is released to the upper tier price. The tax rate would be equal to 50% of the difference between the old oil controlled price and the price at which it is permitted to sell. Similarly, a tax would apply to all upper tier oil which receives price increases as a result of its upward adjustment. The tax would be equal to 50% of the increase between the current controlled price of upper tier and the new levels which that tier may receive as a result of the phase out schedule.

CHART IV

Total Domestic Production

(MMB/D)
$1.50 Case

	1979	1980	1981	1982	1983	1984	1985
Gradual Administrative Decontrol	8.77	8.70	8.63	8.60	8.63	8.70	9.16
Backloaded Administrative Decontrol	8.75	8.64	8.57	8.51	8.47	8.45	8.86

Chart IV, below, shows the tax receipts by fiscal year resulting from the application of these two taxes.

CHART IV

INCREASES IN FEDERAL TAX RECEIPTS
FROM INCOME AND NEW TAXES
(Fiscal Years)

	1980	1981	1982	1983	1984	1985
Option A Backload	1.2	3.3	5.0	5.2	5.1	5.0
Option B Gradual	1.9	4.0	5.3	5.2	5.1	5.0

III. USE OF THE TAX REVENUES

The attached charts, prepared by OMB, outline the possible uses of the receipts from the proposed tax. Two options are provided, which depend upon the level of receipts actually generated from the tax. In order of priority funding is provided for:

- assistance to the poor and near poor
- increases in mass transit funding
- establishment of an Energy Fund

It should be noted that the tax receipts estimated in Chart V assume no real OPEC increases after 1979. If OPEC were to raise its prices, the federal tax receipts would increase substantially. It if for this reason that the following charts show an option which is significantly higher than the revenues estimated in Chart V.

EXHIBIT A - SUMMARY - ESTIMATED TAX REVENUES AND OPTIONS FOR DISPOSITION THEREOF

Current $ in Billions

	FY 80	FY 81	FY 82	FY 80 to 90
Estimated Revenues ($1.50 OPEC Case)	1.2	3.3	5.0	24.9 1/
		#2	#3	
Disposition Options				
I	1.2	1.3	1.4	13.6 to 18.4 2/
II not viable	4.6	5.0	5.3	50.7 to 55.6 2/

1/ Through FY 85 only; estimate not available after 1985
2/ Estimates shown do not include costs after FY 90.

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EXHIBIT B - DESCRIPTION OF INITIATIVES INCLUDED IN OPTIONS FOR DISPOSING OF ESTIMATED TAX REVENUES

CATEGORY

	Assistance to Low Income Households	Assistance for Mass Transit	Additional Energy Initiatives
Option I	Provide: -$100 cash per annum per household with incomes below $7,580 per annum.	Provide: -grant assistance for bus purchase. +5000 -rail rehabilitation assistance to cities with existing rail (subway, trolley, commuter train) transit service. -carpool incentives.	Provide: -regional petroleum storage (23 MMB). -funding for SRC-I. -subsidy for shale oil development. -10% tax credit for agricultural/industrial solar equipment. -15% tax credit for wood stoves. -20% tax credit for passive solar for residential. -tax credit for architects fee of $20/MMBTU saved on commercial buildings. -tax exemption (2¢/gal.) for gasoline with 10% or more of its content from non-oil or gas sources (illustrative; specifics of proposal not final). -funding for NEA authorized solar financing program (SUNNY MAE). -additional funding for coal R&D ($50 million/yr.) and possible loan guarantees for synthetic plants.
Option II	Provide: -$150 cash per annum per household with incomes below $7,580 per annum. -a tax credit of $100 scaled to $0 to households with incomes between $7,480 and $17,100 per annum (median income 1978).	Provide in addition to Option I: -formula grants for additional assistance to purchase buses. -interstate transfer grants; use additional funds from highway trust fund for mass transit purposes.	Provide in addition to Option I: -funding for low-medium btu coal gasification plant. -tax credit for cogeneration using coal. -two-year acceleration of Federal buildings conservation retrofit program. -expansion of the existing Federal solar buildings program. -funding for NEA authorized loan program for low head hydro-electric. -waive existing petroleum import fees and duties.

Conservation

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EXHIBIT C - DISPOSITION OF REVENUE OPTIONS

(Current $ in Millions)

Option	Category	FY 1980	FY 1981	FY 1982	FY 1980-1990
I	A. Low Income Assistance	709	727	744	8,820
	B. Mass Transit				
	-Basic Bus Grants	15	60	100	450
	-Rail Rehabilitation	5	15	25	130
	-Carpool Incentives	100 — ?	100	100	300
	C. Energy Initiatives (See Exhibit D)	365	1.360	2.450	3,852 - 8,677
	OPTION I TOTAL	1,194	1,262	1,419	13,552 - 18,377
II	A. Low Income Assistance	2,700	2,900	3,100	32,747
	B. Mass Transit				
	-Option I Elements	120	175	225	880
	-Interstate Transfers	15	40	80	300
	-Formula Bus Grants	-0-	10	40	225
	C. Energy Initiatives (See Exhibit D)	1,755	1,856	1,863	16,579 - 21,404
	OPTION II TOTAL	4,590	4,981	5,308	50,731 - 55,556

EXHIBIT D - ENERGY INITIATIVES - OPTIONS I - II
(Current $ In Millions)

Option	Initiatives	Budget Impact FY 1980	FY 1981	FY 1982	Cumulative Impact FY 1980-90	Oil Import Savings (M B/D) 1985	1990
I	A. Regional Petroleum Storage (23 MMB)	60	70	20	185	-0-	-0-
	B. Fund SRC-I	70	80	180	525	-0-	0.02
	C. Subsidy for Shale Oil Development	-0-	-0-	-0-	870 - 1144		0.3
	D. Tax Credit for Agricultural and Industrial Solar Applications	20	30	50	390	0.16	0.25
	E. Additional Coal R&D	50	50	50	150	-0-	-0-
	F. 15% Tax Credit for Wood Stoves 1/	75	75	75	450	.03	.03
	G. 20% Tax Credit for Passive Solar 1/	30	45	65	450	.03	.04
	H. Tax Exemption (of 2¢ per gallon) for Gasoline Produced with 10% or more from Coal 2/	-0-	-0-	-0-	722 - 5273	.1	.15 - .48
	I. Fund GNMA Solar Financing Program (Solar Loan Subsidies)	60	10	10	110	N/A	N/A
	TOTAL OPTION I	365	360	450	3852 - 8677		
	(Totals do not include liabilities associated with loan guarantees for Synthetic Plants; estimates of outlays are not available at this time.)						
II	A. Fund Low/Medium BTU Gasification Plant	-0-	70	90	300	-0-	0.10
	B. Tax Credit for Cogeneration Equipment for Coal	147	147	147	882	N/A	N/A
	C. Expand & Extend Federal Bldg. Solar Program	10	40	50	275	N/A	0.10
	D. Fund NEA Loan Program: Low Head Hydro	100	100	(7)	137	N/A	0.10
	E. Accelerate Federal Bldg. Conservation	-0-	133	133	-0-	-0-	-0-
	F. Waive Petroleum Import Fees and Duties	1133	1006	1000	11133	N/A	N/A
	OPTION II INCREMENT	1390	1496	1413	12727		
	COMBINED OPTIONS I and II	1755	1856	1863	16579 - 21404		

Finally, we have begun discussions with the Departments of Energy and Justice to try to identify options which would be available to prevent oil company investment of the increased revenues generated from decontrol in non-energy activities. While these will require additional staffing, proposals in the mill are:

- application of the Justice Department's proposed conglomerate merger legislation to the major oil companies only. This would cover the 23 largest domestic and foreign subsidiary companies. It would prevent acquisitions of any company, energy related or not, over $100 million in assets.

- restrictions on use of oil company revenues to acquire any non-energy companies.

We are also examining, and will provide you a separate memo on, measures which would indicate a "get tough" approach to the oil industry. These include:

- prohibition of the deduction of foreign income taxes paid on the purchase of crude oil, or

- more strict limitations on the types of foreign expenditures which qualify as foreign income taxes (e.g. royalty payments).

These concepts are appealing because they both raise additional revenues and respond to criticism which has been mounted by a number of liberal members of Congress over the last several years.

REASONS FOR ADOPTING BACKLOADED DECONTROL SCHEDULE

1. Inflation: According to our estimates, the differential in CPI impacts in 1979 is .07 between the two options. We believe that this is significant. Further, recognizing that there is uncertainty in the accuracy of the inflation estimates for all elements of these options, it should be noted that the estimates for the impacts of the marginal well proposal is perhaps the most uncertain. The backloaded proposal permits price increases immediately only for 40% of production from marginal wells, whereas the gradual option would permit immediate price for 100% of wells in this category. By taking a smaller first step in this category, we minimize the impacts which might result if our inflation calculations are in error. Under the backloaded option, you can legitimately state that you have taken every reasonable step to avoid inflationary effects in this important year. It will be much harder to make this claim if your program includes a marginal well proposal much more generous than the one we are known to have promised to Jim Wright.

2. Maintaining flexibility: In order for your statement that you may reconsider your decision if the Congress fails to act to be credible, it is important that you have flexibility to do so. DOE's proposal would have you release 100% of marginal oil production and committed to a $2.25 billion plan to finance enhanced oil recovery (EOR) in the first months. Our proposal would release only 40% of marginal well production, so that you could announce deferral of later increases scheduled for '80 and '81, in short, preserves your options better.

3. Technical feasibility: We believe that the proposal to commit to $2.25 billion as front-end financing for enhanced oil recovery will be seen as a poor substitute for the Bentsen bill that the industry wants. The industry has asked repeatedly that DOE get out of the business of certifying eligible EOR projects and leave the matter to the States. Under the current DOE certification procedure, only one person has applied for EOR certification that would permit incremental production to receive higher prices. It will be hard to argue that this proposal will increase production if the industry won't even come in and apply.

4. "White House interference in DOE rulemakings": A substantial portion of Jim's opposition to our back loading proposal seems to stem from the fact that it involves current DOE rulemakings on marginal wells and enhanced oil recovery. DOE has taken the position that legal rules concerning ex parte contracts after the close of the comment period in a rulemaking preclude substantial involvement by your advisors in any decision. We looked into this issue as part of earlier discussions with EPA and the Department of the Interior and believe that it is simply and absolutely without merit in this case. There is no law that says a President cannot direct a cabinet department to take particular actions in a rulemaking, or that his advisors cannot recommend to him that he do so.

REASONS FOR ADOPTING THE GRADUAL DECONTROL SCHEDULE

DOE, Treasury, the State Department, and NSC all believe that the gradual approach to decontrol in 1981 as originally outlined by Secretaries Schlesinger and Blumenthal is the better action. The difference in this option's effect on the rate of inflation in comparison to the "backloaded" approach is minor as noted in the preceding chart. Even more importantly, the gradual approach is superior to the other option with respect to both energy policy and the apportionment of these price increases over the period 1977 to 1981. For example:

Rate of Increases in Domestic Prices

The gradual approach results in a slower rate of increase in domestic oil prices from January 1980 to October 1981. The backloaded approach would, in contrast, produce the fastest rate of increase in domestic oil prices in the middle of the Presidential campaign.

The gradual approach spreads the inflationary increase evenly across the period 1979 to 1981. The CPI effects noted by CEA show that the gradual approach results in CPI increases that are not substantially different than the backloaded approach. The largest difference is in 1979 and amounts to no more than 0.07 percent. The difference in 1980--the campaign year--is the smallest; only 0.04 percent.

Legal Liability of Rulemakings

Both options would require DOE to act on open rulemakings to implement this policy. To the extent that a crude oil pricing policy package results in DOE's drastic alteration of these rulemakings (such as three tiered decline rate as proposed in the backloaded option) or abandonment of the proposed rulemaking (such as abandonment of the tertiary incentives rulemaking as proposed in the backloaded option), then the entire set of actions is made more vulnerable to legal challenges.

The gradual option grants price increases in the order most appropriate for increasing domestic production--marginal wells, then tertiary projects, and only later to the non-marginal lower and upper tier oil that results in the lowest supply response. The backloaded option on the other hand withholds the upper tier

price from 40 percent of the marginal production until mid to late 1981. Yet by that time the backloaded option would have released nearly all non-marginal lower tier oil to the upper tier price. This can only encourage those on the Hill who would grant even more generous increases for marginal production to proceed with legislation.

Domestic Production

The gradual approach will certainly result in higher domestic production than the backloaded approach due to the special tertiary incentives.

Tertiary Provisions

The tertiary program contained in the gradual approach will result in additional oil production of 250 to 300 barrels per day by 1985. Additionally, it will head off any attempts on the Hill to provide yet more generous incentives to tertiary production. The tertiary program in the gradual approach also allows the Administration to argue that it is taking steps to require that some of the increased producer revenues by invested in new production. In contrast, the backloaded approach has no additional incentives for tertiary recovery.

Finally, the difference in the relatives inflation effect of the gradual option as opposed to the backloaded option is no greater than the margin of error in estimating these effects. The real difference is that on political and substantive grounds the elements contained in the gradual approach represent the soundest overall policy.

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"3/29/79 [1]" Box 124

(last document - Cambridge Survey Research dated 3/29/79)

THE WHITE HOUSE
WASHINGTON
29 Mar 79

Stu Eizenstat

The attached was returned in the President's outbox. It is forwarded to you for ~~your~~ appropriate ~~information~~ handling.

Rick Hutcheson

Hamilton Jordan

ADMINISTRATIVELY CONFIDENTIAL

	FOR STAFFING
	FOR INFORMATION
	FROM PRESIDENT'S OUTBOX
	LOG IN/TO PRESIDENT TODAY
	IMMEDIATE TURNAROUND
	NO DEADLINE
	LAST DAY FOR ACTION -

✓	ADMIN CONFID
	CONFIDENTIAL
	SECRET
	EYES ONLY

ACTION	FYI	
		VICE PRESIDENT
✓		EIZENSTAT
	✓	JORDAN
		KRAFT
		LIPSHUTZ
		MOORE
		POWELL
		WATSON
		WEXLER
		BRZEZINSKI
		MCINTYRE
		SCHULTZE

		ADAMS
		ANDRUS
		BELL
		BERGLAND
		BLUMENTHAL
		BROWN
		CALIFANO
		HARRIS
		KREPS
		MARSHALL
		SCHLESINGER
		STRAUSS
		VANCE

		ARAGON
		BOURNE
		BUTLER
		H. CARTER
		CLOUGH
		COSTANZA
		CRUIKSHANK
		FALLOWS
		FIRST LADY
		GAMMILL
		HARDEN
		HUTCHESON
		JAGODA
		LINDER
		MITCHELL
		MOE
		PETERSON
		PETTIGREW
		PRESS
		RAFSHOON
		SCHNEIDERS
		VOORDE
		WARREN
		WISE

paying political costs that while gainful were minor compared to the potential cost on this issue. In comparative terms it is the difference between a stick of dynamite and a fire-cracker.

The need for boldness, the need for broader context, the need for unconventionality, the need for linkage.

Given these legitimate concerns and given the responsibilities of your office it strikes me that to choose between potential political suicide or the shirking of your responsibility is truly a Hobson's choice. My instincts rebel against this unacceptable positioning and since Friday I have become convinced that we must find different a ground from which to stand that allows us better positioning than the quicksand which we are placed.

We must find a course that allows us to do what is right in a way that permits us to rally the country and avoid political disaster. Such a course has four ingridents.

1. Boldness - Your successes have come from bold action. The Mid East is the best example. Given the present situation in the country, only boldness offers the possibility of public attention and support.

2. Broader Context - In the discussion on Friday, I was struck by how narrow the focus was defined. An energy problem with energy solutions but carrying economic, social, and political impacts that dwarft the energy concerns. Yet there was little attention given to approaching this decision in a broader context, making it a part of a larger effort. To have credibility, interest, or support the context of this decision must be broadened.

3. Unconventionality - I was struck by how narrow our options were, not only to solution but also to revenue disbursement. The suggestions were all very conventional. They included neither boldness nor broader context. Your efforts in the Mid East, however, were the essence of these approaches. The inexorable energy decision seems to be carrying us on a course remarkably like that of the inflation program rather than that of the Mid East settlement. Conventional approaches are not working well these days -- they neither solve the problems or provide a basis for capturing the necessary excitement or support of the public so essential for success. We must explore unconventional approaches in these unconventional times.

4. Linkage - We cannot deal with this deregulation decision in a vacuum. The reaction will be linked in the public mind to the threat of visible runaway inflation. To be credible we must link what we do on energy to that general frightening problem of inflation. Avoiding that linkage will not spare us the coupling that inevitably will take place.

With these four ingredients in mind, let me propose an approach which I think might work to extract us from the dilemma in which we now find ourselves.

Two Proposals

1. Food and Energy

The country is not reeling from general inflation. It is panicking over food costs which are running over 30% this year. Economists seem to act as though all inflation is equal. That is not true. Food inflation, measured in small constant increments has by far the greatest psychological impact on consumers than any other inflation. It is their measure of inflation, and we can prove its direct impact on consumer confidence and behavior. As a factor it dwarfts all other economic signals including general inflation. (Second, as earlier pointed out, is energy costs.) It is food inflation that is destabilizing the public and generating frenetic fanatic anticipatory buying which is doing so much to obliterate the projections of your economists.

Premise

My premise is the following: if we could find some way to impact the food sector, or even better to stabilize food prices, or at least the most important food sectors, we could accomplish several things:

a. Settle the country down
b. Encourage savings rather than borrowed spending
c. Convince the country we understand and are doing something about that which is most vital to them
d. Gain us the country's attention and perhaps support
e. Immensely effect our political situation.

Proposal

Therefore, I propose that we investigate the possibility of deregulating oil prices but with the revenues from a windfall

profits tax directed to ward stabilizing food prices immediately. That we study the feasibility over the course of deregulation (into 1981) guaranteeing stable food prices through a program of subsidies to producers.

If feasible, we would accomplish a number of points:

1. We sould be able to tell people that they will spend more for energy, which no longer given world conditions can be subsidized, if they don't conserve but as a tradeoff we will bring certainty and stability to their food costs, an area of basic necessity and inelasticity. My hunch is that given their attitudes and expectations the public would enthusiastically jump at this tradeoff.

2. The revenue taken from the public would be returned in a vital, visible, and exciting way.

3. This move would directly influence the CPI.

4. It would be the kind of bold, broader context, unconventional, and linked action that would capture the public imagination and affect our political fortunes through 1980.

5. It would provide enormous leverage on the Congress through public pressure to pass a windfall profits tax.

6. It would allow us to reach into the heart of the inflation issue which is untouched presently by our guidelines.

7. It would turn this decision from being negativism to positivism.

Feasibility

The first major question arises, is this feasible? I ran it by Schlesinger who pointed out two things:

1) Tommy "The Cork" Corcoran recently, in an unrelated conversation, suggested that we subsidize food much as we did in World War II -- that it worked then and would now.

2) That he felt subsidizing a domestic area like food was much different than subsidies overseas.

I have also talked to Bert Lance who thinks it is an exciting idea.

My thoughts on this grew out of Stu's comment Friday on the negative sales tax on food idea. While I would favor that approach over nothing, I think we should explore the larger more dramatic idea. If revenue amounts are a problem, I'm not sure I wouldn't support quicker or even total deregulation to provide it since it goes right back into the CPI. This action ought not to preclude an Energy Trust Fund or something special for New England.

I realize the idea would need study. At present, however, your advisors are very conventional in their thinking. Bold unconventional thinking is hampered by the peer group pressure not to appear "foolish" or even "weird". Yet, if you took the lead in forcing the look for new ideas as recommended here, my guess is that all kinds of fresh bold thinking might emerge. Even if this idea is unworkable, which I doubt, the process might turn up better and more effective alternatives yet unexplored.

2. OPEC

Given the Geneva decision yesterday, as regards not only the price rise but the surcharge particularly, I wonder if we should not explore the possibility of fighting back. If the Saudis resist the surcharge as indicated, it would seem that the other nations applying it are those most vulnerable to retaliation by the U.S. I wonder if this could be the chink in OPEC's armor that would permit a wedge to be driven into the cartel?

Certainly, if feasible it would allow us to broaden our message next week and rally the country in an effort to protect our own interests. It would undermine the political argument that we are merely puppets on OPEC's strings. It would be a healthy tonic both at home and abroad. This is an additional area, it would seem worthwhile to pursue.

Additional Points

1. New England - We must find a way to soften the blow in New England if deregulation takes place.

2. To link or not link windfall profits tax to deregulation.

I have thought about this a lot since Friday. There is a certain appeal to a clean certain decision not contingent to a tax. However, I think the risks are unacceptable. If we announce certain deregulation I don't believe any incentive will exist from the producing areas for a tax. I don't believe we would have any leverage on Senator Long to stop him from killing or subverting the tax to a major plough back provision.

Also, I think it maybe easier to break a liberal threat to oppose the tax if it is linked to deregulation in order to kill the latter. In that instance we could threaten to deregulate anyway.

Another thought is perhaps to actually begin the first stage of deregulation at the same time a tax is proposed and to threaten to stop the process if a tax is not passed. In other words, whet the appetite but still hold a stick over their heads.

In any case, the food inflation/energy approach would help galvanize public pressure on the Congress in either case.

3. Deregulation vs. World Price - I share Stu's concern at having our domestic oil prices at the mercy of OPEC artificial pricing. I feel though that deregulation is a better mechanism. Schlesinger argues, though that we could tax everything above what we believe to be a fair World Price and I think this or some approach is important to keep us from being charged with putting Americans completely at OPEC's mercy.